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1. INTRODUCTION

As most commentators note, architects of the law governing the limited liability company business form (LLC) in the United States (a relatively late entrant in the U.S. business entity race) could, and did, look to the law of partnerships, limited partnerships, and corporations in formulating LLC law. The *Revised Uniform Partnership Act* (RUPA) was, rather transparently, the original basis for many of the statutory rules in the *Uniform Limited Liability Company Act* (ULLCA). The RUPA codified partnership norms that focus on the co-equal consent of partners for the entity's formation, maintenance, wind-up, and termination. As a result, the ULLCA's RUPA foundation gave the LLC form, in a simple, direct way, the attributes needed to secure pass-through treatment for the entity under federal income tax law while providing limited liability to owners under state entity law, a major driving force behind the LLC. Specifically, under the pre-existing federal income tax regulations, an unincorporated business entity enjoyed pass-through tax treatment if it lacked at least two of four core characteristics of corporations: (1) continuity of life, (2)

centralization of management, (3) limited liability and (4) free transferability of interests.[1]

However, because aspects of the LLC deviated from general partnership law, limited partnership and corporate law policy also have played a role in the creation of LLC rules, and limited partnership and corporate doctrine was grafted onto the RUPA base to some extent in creating the RULLCA. As a result, courts have used both partnership and corporate law principles in deciding LLC controversies that require statutory interpretation or gap-filling. Moreover, the doctrinal rules relating to LLCs have changed over the years, including in response to developing decisional law and federal income tax law changes in 1997 that allowed for more liberal pass-through treatment for unincorporated business entities. As a result, the ULLCA had—and each successor uniform act has continued to have—a palpable, albeit tentative and shifting, hybrid quality about it.

Many aspects of this crossbred existence have generated significant scholarly attention. In particular, issues relating to limited liability (including veil piercing), taxation, management and control (including fiduciary duties), and the overall flexibility of internal governance rules have been well analyzed in the literature—and rightly so. These are important doctrinal concerns, and they are considerations central to the formation and day-to-day operation of a business organized as an LLC.

[1] *See* Treas. Reg. § 301.7701-2(a) (1980); *see also Morrissey v. Comm'r of Internal Revenue*, 296 U.S. 344 (1935).

Issues relating to fundamental changes in LLCs, however—matters such as amendments to organizational documents, mergers, conversions, domestications, and dissolutions—have received measurably less consideration. While they are regular occurrences in the lifecycle of a firm, they are not in front of an LLC's management or legal counsel every day. Having said that, they are critically important to the law governing LLCs, especially in transformative times. Accordingly, this chapter reviews the current state of fundamental change doctrine in the LLC form in the United States, collects and describes key observations on the current (and continually evolving) U.S. laws governing these important transactions, and draws related summary conclusions.

2. A BRIEF DOCTRINAL OVERVIEW

By the end of the 20th century, every state in the union had introduced an LLC statute of one form or another. The first uniform LLC act in the United States, ULLCA, was formalized in 1996, four years after the drafting of the *Prototype Limited Liability Company Act* (PLLCA) by a working group of the American Bar Association's Committee on LLCs, Partnerships and Unincorporated Entities. LLC law continued to develop rapidly through state legislatures in its wake. As a result, The National Conference of Commissioners on Uniform State Laws adopted a new version of the uniform act, the *Revised Uniform Limited Liability Act* (RULLCA), in 2006. Innovations continued. In 2011, in response to significant changes in LLC law introduced in Delaware, the Revised Prototype Limited Liability Company Act

Editorial Board of the LLCs, Partnerships and Unincorporated Entities Committee of the American Bar Association introduced a revised *Prototype Limited Liability Company Act* (RPLLCA). State LLC laws are at varied stages of development and include assorted provisions from these uniform and prototype acts, as well as rules individually crafted to meet specific state policy needs.

The introduction of the series LLC has been an important, complex innovation of state LLC law. In states adopting Delaware-style series LLC provisions, LLC series are treated for most purposes as separate entities within a single LLC entity. Delaware's law serves as the model for this type of LLC, and its statement of this general rule reads as follows:

> A series . . . may carry on any lawful business, purpose or activity, whether or not for profit, with the exception of the business of banking . . . . Unless otherwise provided in a limited liability company agreement, a series . . . shall have the power and capacity to, in its own name, contract, hold title to assets (including real, personal and intangible property), grant liens and security interests, and sue and be sued.[2]

Other states have implemented their own series provisions in their statutes. Some deviate from the Delaware model and most rely on contract (statutorily authorized provisions in, for example, an LLC operating agreement or limited liability company

[2] DEL. CODE ANN. tit. 6, § 18-215 (West 2014).

agreement), at least to some extent, to formalize the specific rights inuring to those holding interests in the series. Accordingly, it is difficult to generalize governance rules in this area across multiple jurisdictions and firms. The series LLC is a relatively new statutory addition and has not yet been widely tested practically or judicially, including in the area of fundamental change transactions. It remains, however, an area to watch.

Notwithstanding series LLC doctrine and other examples of recognized individuality in state approaches to LLC law, there are certain generalizable standards and trends in LLC law concerning fundamental organizational changes. These standards and trends are summarized in the sections below. They highlight a number of important themes and reveal undeniable patterns of interest to businesses and their legal counsel.

The summary offered below focuses on certain key aspects of the law relating to fundamental change transactions. Fundamental change doctrine in LLC law, as in corporate law, comprises legal rules that focus on the nature of transactional authority. Specifically, fundamental change transactions are those that are so basic to the firm that non-manager owners are given an element of control—a right to vote or consent. The summary of fundamental change doctrine in the LLC context that follows therefore focuses on the approval rights of LLC members over basic structural transactions.

Amendments to Organizational Documents

LLC organizational documents typically consist of a chartering document—the document that, when filed with the office of the secretary of state of a state, constitutes the LLC as a legal entity—and an agreement among the members (owners) of the LLC as to the governance rules by which the LLC will operate. The labels for LLC organizational documents have evolved over the years. For example, the ULLCA and PLLCA both use the term "articles of organization" to describe the LLC charter and "operating agreement" to describe the governance agreement among members. However, the RULLCA uses "certificate of organization," and the RPLLCA uses "certificate of formation," to refer to the LLC charter. In addition, while the RULLCA continues to refer to the governance agreement among members as an operating agreement, the RPLLCA refers to that governance agreement as a "limited liability company agreement." State statutes predictably employ a similarly varied set of terms to refer to LLC organizational documents, most of them using the terms provided in the prototype or uniform acts.

Amendments to these LLC organizational documents enjoy a special legal status. As a general matter, the consent of all members is required to amend LLC organizational documents, at least by default. Section 404(c) of the ULLCA, Sections 407(b)(4) and (c)(4) & (5) of the RULLCA, and Section 406(c)(1) of the RPLLCA, for example, all provide for unanimous consent for amendments to the articles or certificate and operating agreement. In some cases, these statutes rely on language

providing for approval by all members of any matter outside the ordinary course of business of the LLC. Unanimity by default is the rule in some state LLC statutes.[3]

However, other variations also are common and seem to be proliferating. Some state LLC statutes allow the required consent of members to be varied in the chartering document. Other state LLC statutes specify the required vote (typically majority, but sometimes supermajority) of members unless the charter or governance agreement provides for a different—sometimes only a greater—vote.[4] Some state LLC statutes provide for different votes based on the subject matter of the amendment, with more fundamental, core changes requiring a unanimous vote and other changes requiring a majority vote.[5] Some states allow managers in manager-managed LLCs

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[3] *See*, *e.g.*, COLO. REV. STAT. ANN. § 7-80-209 (West 2014) ("An amendment to the articles of organization is invalid unless approved by all of the members or in such other manner as may be provided in the operating agreement"); MICH. COMP. LAWS ANN. § 450.4603 (West 2014) (requiring in a certificate of amendment "[a] statement that the amendment or amendments were approved by the unanimous vote of all of the members entitled to vote or by a majority in interest if an operating agreement authorizes amendment of the articles of organization by majority vote."); OR. REV. STAT. ANN. § 63.444 (West 2014) ("Except as otherwise provided in ORS 63.441 [regarding amendments that can be approved by a manager or managers of a manager-managed LLC] or in the articles of organization or any operating agreement, all amendments to the articles of organization or any operating agreement must be approved unanimously by the members.").

[4] *See*, *e.g.*, LA. REV. STAT. ANN. § 12:1318 (West 2014) (providing for a majority vote of the members to approve all amendments to the articles or operating agreement, unless otherwise provided in the articles or a written operating agreement); N.Y. LTD. LIAB. CO. LAW § 213 (McKinney 2014) ("Except as provided in the operating agreement, an amendment of the articles of organization shall be authorized by at least a majority in interest of the members entitled to vote thereon.").

[5] *See*, *e.g.*, OKLA. STAT. ANN. tit. 18, § 2020 (West 2014) (providing for a majority vote of the members for approval of an amendment to the articles of organization or operating agreement, subject to certain exceptions where a unanimous vote is required, unless in either case a different vote is provided in the LLC's article or operating agreement—a written operating agreement being required to vary the

(LLCs in which the management function is performed by one or more persons, who need not be members, named or designated in the manner set forth in the statute) to adopt limited, clerical charter amendments (rather than requiring that members consent to those amendments).[6] Some states—most notably Delaware—treat amendments of the operating, limited liability company, or other governing agreement as a matter of contract by default.[7]

Mergers, Conversions, and Domestications

Doctrinal rules relating to LLC mergers, conversions, and domestications also vary and have evolved significantly over the years. The trend has been toward more types of transactions between and among more and more forms of domestic and foreign business entity. This liberalization generally tracks and follows on developments in corporate doctrine and is illustrated well by the progression of the prototype and uniforms acts.

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unanimity requirement); TENN. CODE ANN. § 48-249-204(c) (West 2014) (requiring approval for an amendment of the LLC's articles by all members, except for an amendment changing the LLC's name or making other specified ministerial changes).

[6] *See*, *e.g.*, 805 ILL. COMP. STAT. § 180/5-15 (West 2014); OR. REV. STAT. ANN. § 63.441.

[7] *See*, *e.g.*, DEL. CODE ANN. tit. 6, § 18-302(e) ("If a limited liability company agreement provides for the manner in which it may be amended, including by requiring the approval of a person who is not a party to the limited liability company agreement or the satisfaction of conditions, it may be amended only in that manner or as otherwise permitted by law . . . ."); TENN. CODE ANN. § 48-249-204(c) ("Any amendment to an LLC's operating agreement shall be approved by the method provided in its LLC documents. If the LLC documents do not provide for the method by which an operating agreement may be amended, all of the members shall approve any amendment to the operating agreement.").

Section 904 of the ULLCA provided for mergers of a limited liability company with or into a domestic or a foreign limited liability company or companies, or one or more domestic or foreign corporations, partnerships, limited partnerships, or other entities. For a domestic LLC that is a party to the merger, the plan of merger must be approved by all of the LLC's members or by the number or percentage of members required in the operating agreement. Conversions, however, were only covered in the ULLCA in a limited way. The relevant provision, Section 902 of the ULLCA, only permits conversions of domestic partnerships and domestic limited partnerships into LLCs. The conversion requires the unanimous approval of the partners or approval in accordance with the terms of the partnership agreement. Domestications are not covered at all in the ULLCA.

What a difference ten years makes . . . . The adoption of the RULLCA reflected significant changes in the doctrine relating to organic transactions—mergers, conversions, and domestications—that constitute fundamental change transactions. Article 10 of the RULLCA provides broadly for LLC mergers, conversions, and domestications. Under Sections 1003(a), 1007(a), and 1011(a) of the RULLCA, respectively: all members of an LLC that is party to a merger must consent to the plan of merger; all members of a converting LLC must consent to the plan of conversion; and all members of a domesticating LLC must consent to a plan of domestication. Sections 1002(a) and 1006(a) of the RPLLCA carry forward the same unanimous approval rules set forth in the RULLCA, but Article 10 of the RPLLCA

classifies a domestication transaction as a type of conversion. Accordingly, the RPLLCA only references mergers and conversions.

Individual states have adopted many different versions of these rules, customized to reflect unique provisions and policy attributes. A number of states do not have domestication provisions in their LLC law; some of these jurisdictions have plans to add domestications to their statutes. In addition, state legislatures have continued to innovate from the evolving rules represented in the uniform and prototype LLC acts. Florida, for example, recently added an "interest exchange" transaction to the list of organic transactions permitted to be entered into by LLCs.[8] Under the new Florida LLC law, interest exchange transactions are the LLC equivalent of the corporate statutory share exchange transaction (an alternative form of business combination provided for in Section 11.03 of the Model Business Corporation Act). Also, Wyoming, in the 2010 revisions to its LLC act, continued to provide for both continuances (which operate like RULLCA domestications) and domestications (in which a foreign LLC is not required to abandon its foreign domicile but is also permitted to validly exist under Wyoming law).[9] Among states that provide for domestications, some provide a narrow meaning to the term "domestication," defining it as only applying to applications of non-U.S. entities for continued existence under domestic LLC law.[10] Other states construe domestication transactions more broadly as repatriations to the state of any U.S. or non-U.S. firm

[8] *See* FLA. STAT. ANN. §§ 605.1031-.1036 (West 2014).
[9] *See* WYO. STAT. ANN. §§ 17-29-1010 & 17-29-1012 (West 2014).
[10] *See*, *e.g.*, DEL. CODE ANN. tit. 6, § 18-212.

organized under the laws of another jurisdiction.[11] Tennessee, which is unique in recognizing a director-managed form of LLC in addition to the more standard manager-managed and member-managed forms, requires the majority approval of directors or managers, as applicable, and members for "[t]he sale, lease, transfer or other disposition by an LLC of all, or substantially all, of its property and assets not in the usual and regular course of business."[12]

Most strikingly, however, state statutes, unlike the prototype and uniform LLC acts, have begun to eschew unanimous member consent requirements in favor of majority approval requirements, especially for mergers.[13] Delaware law provides for approval of a merger plan "by members who own more than 50 percent of the then current percentage or other interest in the profits of the domestic limited

[11] *See*, *e.g.*, WYO. STAT. ANN. § 17-29-1012 (West 2014).
[12] TENN. CODE ANN. § 48-249-705.
[13] *See*, *e.g.*, FLA. STAT. ANN. §§ 605.1023(1)(a) & 605.1043(1)(a) (requiring approval for mergers and conversions by a majority-in-interest of all members with voting rights); NEV. REV. STAT. ANN. § 92A.150 (West 2014) ("A plan of merger, conversion or exchange involving a domestic limited-liability company must be approved by members who own a majority of the interests in the current profits of the company then owned by all of the members"); N.H. REV. STAT. ANN. § 304-C:156 (2014) ("Unless the operating agreement provides otherwise, a limited liability company that is a party to a proposed merger shall approve the merger agreement by majority vote of the members"); *id.* § 304-C:150 ("If the limited liability company agreement of the limited liability company referred to in paragraph II does not specify the manner of authorizing a statutory conversion of the limited liability company or a merger that involves the limited liability company as a constituent party and does not prohibit a statutory conversion of the limited liability company, the statutory conversion shall be authorized by majority vote of the members of the limited liability company"); TENN. CODE ANN. § 48-249-702 & 704 (providing for a majority vote of managers or directors, as applicable, and a majority vote of members to approve a merger or the conversion of a domestic LLC to another entity).

liability company owned by all of the members."[14] Conversions and non-U.S. domestications are subject to approval "in the manner provided for by the document, instrument, agreement or other writing, as the case may be, governing the internal affairs" of the converting or domesticating entity "and the conduct of its business" or, as appropriate, by applicable law.[15] This shift has brought with it the addition of dissenters' (appraisal) rights under certain state LLC laws.[16] Delaware's LLC law authorizes contractual appraisal rights.[17] Other states have followed.[18] These provisions are relatively new and their value has not yet been fully demonstrated.

The overall trajectory of modifications to state LLC merger, conversion, and domestication statutes has been toward enhanced flexibility as to both the form of the transaction and the organizational form of the transactions participants. This trend has principally been executed through the tailored grafting of nomenclature and processes from corporate laws onto LLC statutory frameworks. States that are moving away from requiring unanimous member consent for organic transactions like mergers, conversions, and domestications also are largely following corporate models.

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[14] DEL. CODE ANN. tit. 6, § 18-209(b).
[15] *Id.* §§ 18-212(c)(6) & 18-214(h).
[16] *See*, *e.g.*, FLA. STAT. ANN. §§ 605.1061 – 605.1072; NEV. REV. STAT. ANN. §§ 92a.300 – 92a.500; N.H. REV. STAT. ANN. §§ 304-C:160 – C:172.
[17] *See* DEL. CODE ANN. tit. 6, § 18-210.
[18] *See*, *e.g.*, TENN. CODE ANN. § 48-249-706.

Yet, the corporatization of fundamental change rules does not portend the corporatization of LLC law as a whole. A 2013 Delaware Chancery Court case reviewing a post-conversion claim for advancement and indemnification from an LLC illustrates this point. The LLC was the successor of a corporation in a conversion. The claimant was a director and chairman of the predecessor corporation and a member of the governing board and chairman of the successor LLC. The claim for indemnification related to actions taken by the claimant during the time that he was working for the predecessor corporation. The Chancery Court denied the plaintiff's claim for advancement and indemnification because the LLC's operating agreement did not authorize the advancement and indemnification.

> The change of the entity from Ashbridge Corporation to Ashbridge LLC was a fundamental change in identity. The advancement and indemnification scheme of Ashbridge Corporation's bylaws was re-written into contractual terms in Ashbridge LLC's operating agreement in a manner that substantially altered the rights and obligations of the parties. . . . The Court will therefore not impose retroactive obligations on a limited liability company when the plain language of its operating agreement would not permit predecessor or affiliate liability and when the indemnification schemes of the predecessor corporation and successor limited liability company differ.[19]

[19] *Grace v. Ashbridge LLC*, CIV.A. 8348-VCN, 2013 WL 6869936 (Del. Ch. Dec. 31, 2013) (footnotes omitted) (citing to *Bernstein v. TractManager, Inc.*, 953 A.2d 1003 (Del. Ch. 2007) for support).

Thus, as this opinion illustrates, there may be significant potential traps for the unwary that emanate from the relative merger, conversion, and domestication freedom permitted in the LLC context.

Dissolutions

Dissolution rules in the LLC were originally derived from a partnership model in order to assure pass-through treatment for LLCs under then applicable federal income tax law. Specifically, partnership norms that provided for dissolution in the event of the dissociation of a partner from the firm were incorporated into the LLC form to avoid the continuity of existence attribute of the corporate form, since pass-through income tax status under pre-existing federal law was linked in part to limited (as opposed to perpetual) entity existence. Once pass-through tax status was de-linked from continuity of interest and other core corporate attributes, LLCs were free to innovate toward individualized contractual dissolution events that allow for perpetual existence.

Section 801 of the ULLCA, introduced almost coincident with these federal tax law changes, edged toward that objective. Under the ULLCA, while the separation (dissociation) of an LLC member from the LLC has the potential to dissolve the LLC, dissolution is not an automatic effect of LLC member dissociation. Although members can apply to a court for dissolution under specified circumstances set forth in the ULLCA (frustration of the LLC's economic purpose, the conduct of

another member making continuation of the business with that member reasonably impracticable, the reasonable impracticability of conducting the company's business in conformity with the articles of organization and the operating agreement, and illegal, oppressive, fraudulent, or unfairly prejudicial managerial action), for the most part, dissolution events can be set forth in or varied in the LLC operating agreement.

RULLCA and the RPLLCA retain this relative freedom of contract and push further toward corporate dissolution rules, including in the case of RULLCA those applied by legislatures and courts for principal use in the close corporation context. For example, Section 701 of the RULLCA adds both the consent of all of the members as a default dissolution event and also an express provision for an alternative (non-dissolution) remedy for illegal, fraudulent, or oppressive managerial conduct. The latter allows for buyouts of member interests on a showing of managerial oppression without triggering dissolution of the firm as provided for in Section 14.34 of the Model Business Corporation Act. The RPLLCA provides for only five simple, straightforward dissolution triggers: (1) an event or circumstance set forth in the limited liability company agreement, (2) the consent of all the members, (3) with the requisite consent, LLC delinquency that is not cured over a three-year period, (4) ninety days after dissociation of the last remaining member, and (5) on application by a member, a court order because it is not reasonably practicable to carry on the LLC's activities in accordance with the limited liability company agreement.

Like the RULLCA, some state laws combine partnership dissolution and dissolution-related provisions from the RUPA (including, for example, dissolution events that include member dissociation and buyouts) with corporate law dissolution concepts (including, for example, authority to dissolve an LLC or authorize a member buyout based on managerial oppression, detailed provisions on other forms of judicial dissolution, and rules providing for administrative dissolution).[20] Some of these state LLC laws provide that dissolutions require the approval of a majority, rather than all, of the members of the LLC.[21] Delaware law provides for five dissolution events: (1) the time specified in the limited liability company agreement (acknowledging expressly that the LLC otherwise has a perpetual existence by default), (2) the happening of events specified in the limited liability company agreement, (3) "unless otherwise provided in a limited liability company agreement, upon the affirmative vote or written consent of the members of the limited liability company . . . by members who own more than 2/3 of the then-current percentage or other interest in the profits of the limited liability company owned by all of the

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[20] *See*, *e.g.*, COLO. REV. STAT. ANN. §§ 7-80-801 – 80-813 (West 2014); FLA. STAT. ANN. §§ 605.0701-.0717; N.H. REV. STAT. ANN. §§ 304-C:98 – C:105-A & §§ 304-C:127 – C:146; N.M. STAT. ANN. §§ 53-19-38 – 53-19-46; TENN. CODE ANN. §§ 48-249-601 – 622; WYO. STAT. ANN. §§ 17-29-601 – 701(a)(v)(B).

[21] *See*, *e.g.*, N.H. REV. STAT. ANN. § 304-C:129 ("Unless the operating agreement provides otherwise, a limited liability company shall be dissolved by majority vote of the members."); N.M. STAT. ANN. § 53-19-39 (West) ("A limited liability company is dissolved . . . except as otherwise provided in the articles of organization or an operating agreement, upon the written consent of members having a majority share of the voting power of all members"); TENN. CODE ANN. § 48-249-603(b)(2) ("If the proposed dissolution of the LLC is approved at a meeting of the members by a majority vote, or such other vote as may be provided for in the LLC documents, the LLC shall be dissolved").

members," (4) with certain exceptions, when there are no remaining members, and (5) by judicial decree on application "whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement."[22]

3. RESULTING OBSERVATIONS

The history and current state of fundamental change doctrine in the LLC form of business association give rise to a number of important observations. Several of these merit a brief commentary. These observations are set forth below grouped under three principal subject matter headings: the influence and interplay of corporate law and freedom of contract, vested rights and fundamental changes, and legislative drafting choices.

Influence and Interplay of Corporate Law and Freedom of Contract

No accurate summary of fundamental change doctrine in LLC law could fail to highlight two key drivers of the development of that doctrine: corporate law rules (noted at the outset in this chapter) and principles of freedom of contract. These two influences on fundamental changes under LLC law are both predictable and potentially contradictory. As a result, policy considerations played out in the courts and the legislature have been and continue to be important to LLC fundamental change doctrine.

[22] DEL. CODE ANN. tit. 6, §§ 18-801 & 18-802.

Corporate law is both familiar and well developed. Those who formerly organized corporations and are familiar with corporate norms now often choose the LLC form for their businesses because of its inherent flexibility. Repeat players in the entity formation game—business lawyers included—are accustomed to corporate norms and understand the ways in which those norms solve recurrent, common problems in business entity formation and maintenance. Fundamental changes in LLCs resemble and raise questions similar to those raised by fundamental changes in the corporate context. It is unsurprising, and perhaps even rote and efficient, that the judiciary and legislators look to solve these problems, including those involving LLC fundamental changes, with the time-tested (albeit sometimes imperfect) solutions offered by corporate law. Tennessee LLC law has gone so far as to provide expressly for a director-managed form of LLC that incorporates corporate law structures and norms into LLC law in their entirety.[23]

The trend away from unanimous consent, especially as an immutable rule, illustrates the influence of corporate law. In an entity of any size, unanimous consent may be difficult to obtain. A business entity's inability to amend its chartering document or governance agreement, to obtain approval of a business combination or form or domicile change, or to dissolve, liquidate, and terminate its existence distracts management and imposes weighty costs on operations that decrease the value of the business unnecessarily. Corporate law had already

[23] *See*, *e.g.*, TENN. CODE ANN. § 48-249-401(c) & (d), 402(c) & (d), and 403(i).

traveled this path by providing for majority and supermajority votes in these circumstances, balanced by other governance rules that protected or compensated shareholders (notably, in specific cases, fiduciary duties of the majority to the minority, entire fairness review for cash-out mergers, and appraisal rights for dissenting shareholders). LLC law has looked to and incorporated many of these same rules.[24]

Dissolution provides another good example of the effects of corporate law on LLC doctrine. The description of legislative changes provided in the preceding part of the chapter belies an interest in using corporate law as a foundation to evolving LLC dissolution doctrine. But courts also have contributed to this corporatization.

Specifically, some courts applying and construing the original RUPA partnership-based dissolution schemes compellingly analogized closely held corporations to closely held LLCs—entities, in each case, operated and controlled by a small number of members, often comprising friends and family. These courts interpreted and filled gaps in LLC statutes in a manner consistent with corporate doctrine, including by ordering dissolution when it had not been requested as a remedy or fashioning alternative remedies when dissolution had been requested as a remedy. The

[24] *See*, *e.g.*, sources cited *supra* notes 16-18 (regarding statutory institution and facilitation of LLC appraisal rights); *Allen v. Devon Energy Holdings, L.L.C.*, 2012 Tex. App. LEXIS 2110, at *87 (Tex. App. Houston 1st Dist. Mar. 9, 2012) (recognizing a fiduciary duty of the majority to the minority under Texas LLC law);.*Anderson v. Wilder*, 2003 Tenn. App. LEXIS 819, at *9 (Tenn. Ct. App. Nov. 21, 2003) (recognizing a fiduciary duty of the majority to the minority under Tennessee LLC law); *Brazil v. Rickerson*, 268 F. Supp. 2d 1091, 1097, 1099 (W.D. Mo. 2003) (recognizing a fiduciary duty of the majority to the minority under Missouri LLC law).

opinions in these cases note circumstances substantially similar to those underlying court determinations made under corporate law and apply corporate law rules.[25]

An accompanying trend in LLC law toward freedom of contract is sometimes at odds with the movement toward incorporating corporate law principles into LLC law. Partnership law under the RUPA places heavy emphasis on the contractual relations of the partners. Under the RUPA, with minor exception, the partnership agreement controls the relations between and among partners and between partners and the partnership. Corporate doctrine is a very detailed, rich body of law that includes comprehensive substantive and procedural rules. Most of these rules are default rules rather than immutable rules, but corporate law tends to employ majoritarian default rules rather than more tailored, bespoke principles. LLC law's origins in partnership law norms responded in part to a perceived need for more flexibility and customization than is provided in corporate law. The preservation and enhancement of freedom of contract principles in LLC law tends to create some tension with the increasing influence of corporate law on LLC law.

Delaware is the leading and classic example of a state that has more frequently chosen to evolve its law toward increased freedom of contract, although other jurisdictions have adopted some of Delaware's specific pro-contract rules. Delaware LLC law serves as a primary model for the RPLLCA, which has a decidedly

[25] *See*, *e.g.*, *Dickson v. Rehmke*, 78 Cal. Rptr. 3d 874 (3d Dist. 2008); *Kirksey v. Grohmann*, 754 N.W.2d 825 (S.D. 2008).

contractarian tilt. The statutory law in Delaware expressly incorporates a freedom of contract objective by articulating a policy "to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."[26] Other states also have adopted this express statutory norm.[27]

The legislature has spoken, and the Delaware courts understand their marching orders. The Delaware case on post-conversion advancement and indemnification described earlier in the chapter relies heavily on notions of freedom of contract, for example.[28] In another case, the Delaware Chancery Court denied an LLC member's request for judicial dissolution based on the court's interpretation of the LLC's governance agreement.

> I have found that Section 2.2 of the LLC Agreement applies generally to exclude all rights associated with membership not required by law or expressly granted in the LLC Agreement. Because a right to judicial dissolution is not required by law or expressly granted in the LLC Agreement, and because reading the Agreement as a whole it is clear that the parties

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[26] DEL. CODE ANN. tit. 6, § 18-1101(b).
[27] *See*, *e.g.*, KAN. STAT. ANN. § 17-7662 (West 2014) ("The policy of the Kansas Revised Limited Liability Company Act . . . is to give the maximum effect to the principle of freedom of contract and to the enforceability of operating agreements."); KY. REV. STAT. ANN. § 275.003(1) (West 2014) ("It shall be the policy of the General Assembly through this chapter to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements.").
[28] *See supra* note 19 and accompanying text.

> meant to exclude any right to judicial dissolution, I find that the Plaintiff does not have a right to seek a dissolution . . . .[29]

That trial court judgment, affirmed by the Supreme Court, illustrates the triumph of contract law over corporate principles applicable to closely held entities that have been applied, as earlier noted, by courts in other states.

In all jurisdictions, courts must determine the extent to which statutory provisions, including those imported from corporate law, foreclose the exercise of freedom of contract by LLC members. Often, the job is made more difficult by a lack of clear policy directives from the legislature. In those circumstances, general common law norms tend to form the basis of the courts' judgments. One scholar in the area describes this environment in a compelling way. Her words in this regard are worth repeating here.

> The developing strains of business entity governance hold the promise of promoting the interest in contractual freedom while, at the same time, balancing the important need for minimum standards to protect legitimate expectations of fair and equitable conduct on the part of one's business partners. The contractarian model should acknowledge the need for and

[29] *Huatuco v. Satellite Healthcare*, CV 8465-VCG, 2013 WL 6460898 (Del. Ch. Dec. 9, 2013), *aff'd*, 93 A.3d 654 (Del. 2014); *see also*, *e.g.*, *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, CIV.A. 3803-CC, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008).

> importance of such mandatory minimum standards to govern business relationships.
>
> Regardless of how courts articulate their judicial tests, reverence for the written contract must be tempered with the recognition that judicial review is a good and essential thing, as is a mandatory core of acceptable manager and/or member conduct. It has been said that the "defining tension" in corporate governance today is the tension between deference to directors' decisions and the scope of judicial review. In this debate, I have suggested that the uncertainty of the law, and the corresponding specter of judicial intervention, are not unfortunate consequences to be avoided by the creation of a perfect statutory phrase or judicial test. Rather, judicial review is the healthy price and the all-important force that deters overreaching and enables the application of behavioral constraints within the context of our contractual scheme of self-governance.[30]

This quoted passage identifies statutory and common law elements of LLC governance, including especially the existence and application of fiduciary duties in the LLC context, as central, foundational standards that courts use in mediating the tension between standardized entity law norms and contractual freedom. The

[30] Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1654 (2004) (footnotes omitted).

quoted passage suggests that this judicial oversight is both constant and beneficial as a check on opportunistic behavior in business entities.

However, there is some sentiment favoring and movement toward making fiduciary duties purely contractual or fully waivable. Delaware LLC law, for example, allows for the full customization of fiduciary duties in the limited liability agreement but also provides that the implied contractual covenant of good faith and fair dealing may not be eliminated.[31] New York law also permits the waiver of fiduciary duty in LLCs.[32] The implementation of rules of this kind will change the role that judicial enforcement of fiduciary duties has played in adjusting the equities among business venturers participating in LLCs.

Vested Rights and Fundamental Changes

Ownership interests—member interests—in LLCs are personal property. Initial LLC rules requiring unanimous member consent for fundamental changes derived from the belief that an LLC member, as a business owner, has a vested property right in his, her, or its ownership interest. The recognition of the vested rights doctrine vis-à-vis fundamental change transactions, however, imbued minority ownership interests with hold-up value that had the capacity to foster inefficiencies and

[31] DEL. CODE ANN. tit. 6, § 18-1101(c) & (e). In 2013, the Delaware legislature clarified that default fiduciary duties do, in fact, exist under Delaware LLC law, a matter that, together with fiduciary duty waivers, had been a litigable issue. *See* DEL. CODE ANN. tit. 6, § 18-1104; *Gatz Props., LLC v. Auriga Capital Corp.*, 59 A.3d 1206 (Del. 2012); *Feeley v. NHAOCG, LLC*, 62 A.3d 649 (2012) (Del. Ch. 2012).
[32] *See Pappas v. Tzolis*, 20 N.Y.3d 228 (2012).

stagnate the firm. The summary of fundamental change law in the LLC context provided earlier in the chapter demonstrates that few fundamental changes currently require unanimous consent. LLC law has moved away from the recognition of vested rights that require the unanimous consent of members for the approval of fundamental change transactions.

Some state legislatures have made this choice quite explicitly by including a renunciation of vested rights in their LLC statutes. For example, Utah law generally provides that, "[e]xcept as may otherwise be expressly provided in the articles of organization or operating agreement, a member has no vested property right resulting from any provision in the articles of organization, including any provision relating to management, control, capital structure, purpose, duration of the company, or entitlement to distributions."[33]

Some states make more specific express provision on the lack of vested rights of LLC members. Tennessee law offers an example of this approach. Tennessee's original LLC law (which continues to exist in parallel with its revised LLC Act) provides that an LLC member "does not have a vested property right resulting from any provision in the articles or operating agreement, including provisions relating to management,

[33] UTAH CODE ANN. § 48-2c-407(2) (West 2014); *see also* KY. REV. STAT. ANN. § 275.003(6) ("No member or other person shall have a vested property right resulting from any provision of the operating agreement which may not be modified by its amendment or as otherwise permitted by law.").

control, capital structure, distribution entitlement or purpose or duration of the LLC."[34] Virginia law includes a similar provision.[35]

In a rudimentary sense, the developments in LLC law relating to the vested rights doctrine exemplify the overall evolution of LLC law. Specifically, the decline of unanimous consent provisions—especially mandatory ones—and the abandonment of the vested rights doctrine in LLC fundamental changes manifest both the comparable evolution in corporate law and notions of freedom of contract. Business owners that choose to organize their firm as an LLC understand that the state can alter LLC law and that, consistent with that law as in effect from time to time, they have the ability to agree around a variety of statutory default rules, including many of those relating to fundamental changes. Although other aspects of LLC law (notably, fiduciary duties, the obligation of good faith and fair dealing, and oppression relief in the dissolution setting) continue to protect minority interests in the fundamental change environment, vested property rights no longer provide that protection under most state LLC acts.

Legislative Drafting Choices

The history and current state of LLC fundamental change doctrine offer legislatures the motive and opportunity to create more streamlined, coherent, user-friendly

[34] TENN. CODE ANN. § 48-209-101(b).
[35] VA. CODE ANN. § 13.1-1014.E. ("A member of a limited liability company does not have a vested property right resulting from any provision of the articles of organization.").

statutes governing LLCs and business entities more generally. In particular, similarities in filing processes, the liberalization of organic transactions to allow for mergers, conversions, and domestications in and among all statutory business forms, and the adoption of significant corporate law norms in LLC law fairly beg for rationalization. Commentators have been suggesting consonant changes to entity law since the 1990s.

The bar undertook to create legislative change momentum. The American Bar Association established a Business Law Ad Hoc Committee on Entity Rationalization in 2001. In 2002, the committee released the Model Inter-Entity Transactions Act (MITA), which focused on simplifying statutory entity rules relating to fundamental changes. The MITA was later combined with a similar initiative undertaken by the National Conference of Commissioners on Uniform State Laws (the Uniform Entity Transactions Act), resulting in the publication of and subsequent revisions to the Model Entity Transactions Act (META). The advent and transformation of LLC law—and especially the fundamental change provisions—were strong motivations for these projects.

A few state legislatures have begun to undertake the task of revising, consolidating, and generally simplifying their business entity statutes. The development of fundamental change doctrine and, more particularly, the evolution of the law governing organic transactions, have been catalysts for those legislative initiatives. Some state initiatives focus only on reorganizing the law applicable to organic

transactions. Other states have incorporated broader changes in corporate governance rules in their reform efforts. Although the approaches (like the rules they incorporate) vary from state to state, several different ways of approaching the relevant legislative drafting have emerged.

Traditionally, all of the fundamental change rules for each form of business entity were located in the statute for that particular business entity. In other words, the rules for amendments to organizational documents, mergers, conversions, domestications, and dissolutions for LLCs in any individual state were located solely in the state's LLC act. That remains true in most states.

However, a few states have adopted "junction box" statutes. In these states, the common substantive and procedural rules for organic transactions are collected in a separate act among the business entity statutes of the state. Alabama, Colorado, Connecticut, and Nevada and are four states that have adopted a "junction box" approach. The META also represents a version of this approach. In each case, the fundamental change provisions in individual entity statutes within the adopting state are preserved to some extent despite the adoption of a separate statute governing these transactions. This aspect of junction box statutes limits their value as simplification measures in that practitioners may need to look at two or more separate laws—the junction box statute and the statutes governing the individual entity or entities subject to the action.

Texas has taken a related but distinct approach that addresses this inefficiency to some extent. The Texas law expressly articulates its purpose: "to make the law encompassed by this code more accessible and understandable by: (1) rearranging the statutes into a more logical order; (2) employing a format and numbering system designed to facilitate citation of the law and to accommodate future expansion of the law; (3) eliminating repealed, duplicative, expired, executed, and other ineffective provisions; and (4) restating the law in modern American English to the greatest extent possible."[36] To achieve these aims, Texas organizes all of its business entity laws under a comprehensive business organizations code. The code begins with a title that incorporates consolidated fundamental change rules and other provisions generally applicable to all forms of business entity. The individual entity laws are separate titles within the Texas Business Organizations Code, the code having replaced in their entireties all of the predecessor standalone state entity laws. These separate entity law titles state the required vote for actions by LLCs (including the required vote for fundamental changes), but otherwise do not address fundamental changes. Accordingly, to a great extent, the Texas model keeps all fundamental change provisions in one place, in one title, regardless of the form of entity.

Other states have reformed their LLC laws, including especially their fundamental change provisions within those laws, to make them more internally consistent and more consistent with analogous provisions across forms of entity while keeping all

[36] TEX. BUS. ORGS. CODE ANN. § 1.001 (West 2014).

fundamental change rules within each distinct entity law statute. Florida undertook this kind of legislative overhaul. The revisions were effective on January 1, 2014, and effective January 1, 2015, all Florida LLCs were required to comply with the revised LLC act.

> The structure of the new act for organic transactions is a big improvement over existing law, with the provisions for each organic transaction modeled in the same manner (there are six sections for each of the four types of transactions, each set in the same order and having the same descriptive captions, with the subsections of each section in the same order). Generally, these provisions correspond to article 10 of the uniform act, except that the definitions (other than those dealing with appraisal rights) have been relocated to the general definition section of the new act and the appraisal rights provisions in the existing law have been placed at the end (the uniform act does not contain appraisal rights).[37]

Changes of this nature are common as bar association groups and legislatures struggle with how to best accomplish improvements in the evolving law of fundamental changes for LLCs and other forms of entity without undertaking large, time-consuming revision projects.

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[37] Louis T. M. Conti & Gregory M. Marks, *Florida's New Revised LLC Act, Part IV*, FLA. B.J., March 2014, at 27, 28 (footnotes omitted).

4. CONCLUSION

The law applicable to fundamental changes in LLCs has been developing both rapidly and continuously since the introduction of the LLC form. These changes have not been entirely consistent from state to state. Nevertheless, they do have certain commonalities.

Both corporate law and freedom of contract principles have influenced developments in the legal doctrine of LLC fundamental changes. For example, approval requirements for fundamental changes have largely moved away from unanimity, and dissenters' rights and a dissolution remedy for member oppression have been grafted into LLC law from corporate law. Yet LLC statutes also have increasingly comprised default rules that allow LLC constituents to order the affairs of the LLC for themselves.

The corporatization of and contractarian bent to LLC law sometimes come into conflict. Fiduciary duty law, historically a mediating factor in that conflict, threatens to evolve toward freedom of contract norms. If taken to an extreme, this trend would compromise fiduciary duty's historical role as interstitial doctrine that preserves equitable conduct in business enterprises.

Dominant corporate law rules coexist peacefully with freedom of contract norms in the LLC response to vested rights, however. Contemporary LLC law has rejected the

original emphasis on the vested personal property rights of business owners, earlier eschewed under corporate law. Unanimous consent requirements for fundamental changes have all but disappeared. In some cases, appraisal rights have arisen, as they did under corporate law, on a mandatory or default or contractual basis. In other cases, freedom of contract in the LLC form has completely supplanted any vested rights previously recognized in the LLC law governing fundamental changes.

These developments put pressure on the drafting of LLC law by state legislatures. There is wide acknowledgement of redundancies in the laws governing fundamental changes within LLCs and as among different forms of entity and a perceived overall need for simplification of LLC law generally and fundamental change doctrine specifically. Model statutes and legislative initiatives offer varied approaches to LLC law reform, and modifications to the laws governing organic transactions and other fundamental changes have been the foundation of many of these projects.

While LLC fundamental change law has been understudied, it is important to the development of LLC law and the overall law of business entities. Although LLC law originally was patterned after partnership law, LLCs often operate more like corporations in fundamental change contexts. Doctrine has developed to respond to that fact. Having said that, the LLC law applying to fundamental changes also retains (and in some cases has returned to or built on) the contractarian roots of LLC law, incorporating freedom of contract principles that distinguish LLC law meaningfully from corporate law. In this environment, state legislatures struggle with the

complexity of and arising from changes in LLC fundamental change doctrine. Some have begun to respond to these challenges with creative approaches to structuring LLC law. More innovation in this respect can be expected and should be welcomed.

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