
**LEGAL AND TITLE-INSURANCE ISSUES IN LIMITED LIABILITY COMPANY
REAL-ESTATE TRANSACTIONS**

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Legal and Title-Insurance Issues in Limited Liability Company Real-Estate Transactions

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I. Introduction

Limited Liability Companies (“LLCs”) came into existence more than twenty-five years ago as an outgrowth of and response to foreign limited-liability entities encountered in international trade, including the German “Gesellschaft mit beschaenkter Haftung” (“GmbH”) and the Latin American “limitadas”, which were entities similar to corporations or limited partnerships but structured to have more flexible management and return-on-investment mechanisms while avoiding personal liability. The principal purposes of LLC formation are to obtain favorable tax benefits, create and maintain contractual flexibility (including the freedom of members to contract among themselves with respect to financial aspects of the LLC and the management and standards governing the internal affairs of the LLC such as the establishment of classes of members, voting, and procedures for holding meetings or considering matters without a meeting), and shield a member’s personal assets from claims of outsiders and other members. LLCs have become increasingly popular as vehicles for structured-financing transactions, which require the use of entities that are specifically designed to achieve various goals and involve tax, accounting, bankruptcy, securitization and commercial considerations. As a result of favorable tax-revenue rulings by the IRS in recent years and the enactment of state LLC statutes, this form of ownership has proliferated.

All fifty states, as well as the District of Columbia, have adopted LLC statutes. Wyoming, which enacted the first LLC statute in 1977, did so primarily at the request of the large mining businesses located in the state. *See* William D. Bagley, *The History of the LLC in the USA*, Limited Liability Company Reporter 94-302C (May/June 1994). Many states have revised and updated their LLC legislation in the past few years. In Illinois, for example, the Illinois Limited Liability Act, 805 ILCS 180/1-1, was revised by the enactment of P.A. 90-0424 (also referred to as SB 1020), which became effective on January 1, 1998 (the “Revised Act”). The revisions affect the organization and operation of Illinois LLCs, and the Revised Act applies to all LLCs organized under Illinois law on or after such date. Companies formed prior to January 1, 1998 were not subject to the provisions of the Revised Act (unless they formally elect otherwise and so notify the Secretary of State on their domestic annual reports) until January 1, 2000, upon which date the Revised Act applied to all Illinois LLCs.

II. Organizational and Governance Issues

Owners of an LLC are called “members” (rather than partners or shareholders), the LLC is called a “company” (rather than a partnership or corporation), and the ownership interests are called “membership interests”, or simply “interests.” An LLC is a separate legal entity that is generally permitted to carry on any lawful business, purpose or activity (except, in some states,

insurance or banking). Any natural person, entity or association (including a nonresident alien or another LLC) may generally be a member.

LLCs share features of both corporations and partnerships, including the following characteristics:

1. Similarities to partnership – membership is not freely transferable; an LLC may terminate if a member dies, withdraws or becomes insolvent; an LLC confers limited liability on the members and is a separate entity from its members. An LLC is an unincorporated entity that enjoys the “pass through” tax advantages of a partnership (i.e., the tax benefits and liabilities flow directly to the owners; there is no double taxation, at both the entity level and the ownership level, as there would be in a corporation). A member-managed LLC is similar to a general partnership in management concept.
2. Similarities to corporations or limited partnership – an LLC confers limited liability on its members (who, like the shareholders in a corporation, are not liable for the debts, obligations or liabilities of the LLC) and is an entity separate from its members. A manager-managed LLC is similar to a limited partnership.

An LLC may be managed by its members or by managers who may or may not be members of the LLC, depending on state law and the articles of organization and the operating agreement. The managers of an LLC are equivalent to the board of directors of a corporation, or the managing partners of a partnership (except that the managers may or may not have an ownership interest in the entity). If the operating agreement is silent, many LLC statutes provide that the members or managers must act by majority vote at a meeting attended by a majority of the members. Unless stated otherwise in the articles of organization or the operating agreement, the exclusive authority to act on behalf of the LLC resides with the members or managers to whom or which the management function has been given or reserved. In a manager-managed LLC, only the managers can contract for the company’s debts or execute documents for the acquisition, mortgage or disposition of the company’s property.

Depending on state law, the articles of organization (which may also be called a certificate of formation or other name, depending on the laws of the state where the LLC is formed) may be signed by an attorney in fact or one or more the initial members; in some states the articles of organization need not list the members’ names. Some states (such as Delaware) permit oral operating agreements.

The governance provisions of the LLC are set forth in either the articles of organization or the operating agreement. The articles of organization are filed with the Secretary of State or other similar official. The articles of organization generally contain basic public information such as the LLC’s legal name, address, purpose, and similar matters, much like a limited partnership certificate. The operating agreement is similar to a corporation’s by-laws or a limited partnership’s partnership agreement, and governs the operation and management of the LLC.

III.

Lender Concerns and Requirements

None of the members of an LLC has liability of any kind unless otherwise provided for in the articles of organization or operating agreement, or unless expressly assumed. If properly created, an LLC is treated as a partnership for tax purposes. If a court recharacterizes the entity, the LLC would pay taxes at the corporate rate retroactively from the date of organization, and periodic non-liquidating past and future cash distributions would be treated as dividends or, possibly, as salary; in addition, there may be adverse tax implications for “stockholders,” and therefore on the financial solvency of a key developer or managing member. The lender will therefore be justifiably concerned that the LLC maintains its status as such an entity during the term of the loan. See W.A. Steiner, *Lending to a Limited Liability Company – A Lender’s Concern*, 24 Mich. Real Prop. Rev. 219 (Winter 1996). Also, because an LLC is a pass-through entity, a lender making a mortgage or loan to an LLC may have to permit distributions of cash to pay taxes.

The following are common lender requirements for LLC documentation.

1. Articles of organization (certified copies).
2. Latest financial statements.
3. Opinion of borrower’s and lender’s counsel affirming the organization and standing of the LLC, due power and authorization, absence of usury, enforceability of the loan documents, etc.
4. Operating agreement(s) (certified by the “secretary?”).
5. Certificate of good standing or a certificate regarding the full force and effect of the LLC’s current articles of organization. (Note: A recent amendment to Michigan’s Limited Liability Company Act provides that an LLC is entitled to issuance from the State, upon request, of a certificate of good standing, which “shall state that it has been validly organized as a domestic limited liability company, that it is validly in existence under the laws of this state, and that it has satisfied its annual filing obligations.” A certificate of good standing may also be issued to a foreign LLC. MCL § 450. 4207a (1) (2003)).
6. Separate guarantee(s) of the individual member(s) (if deemed necessary by the lender to obtain personal liability).
7. Certificate as to membership.
8. Certificate as to authorized signatures.
9. Certified copy of borrowing/banking resolutions.
10. Certificate of Authority? “Minutes?” Incumbency Certificate?

Property management is often handled, pursuant to the operating agreement, by a managing entity that may or may not be affiliated with the LLC. Any such management agreement must be carefully reviewed and approved by a lender making a loan to and obtaining a mortgage or other security interest in the assets of the LLP. The lender may wish to obtain a specific assignment of the management agreement or subordinate it to the recorded mortgage loan documents.

The borrower may request that an LLC into which title to the property is proposed to be transferred, containing the same managing persons or partners as the existing borrower, be considered a “convenience” transfer rather than a prohibited or controlled transfer in violation of the due-on-sale clause in the mortgage. Should a lender consent to its borrower merging into an LLC? In the case of an LLC formed by merging entities, will the general partner of a partnership involved in the merger have continuing liability for obligations incurred by the entity after the merger?

Some commentators have suggested that an LLC might be used as a method of enabling the lender to generate additional income and/or control over the borrower, i.e., the lender and borrower would form an LLC and provide, in the operating agreement, that the lender would have the right to “a fixed percentage of return on its investment (interest), a priority capital return (amortized payout), and the right to own in the event of failure of the company to pay as agreement (foreclosure). This method avoids problems and delays associated with bankruptcy and redemption periods.” Joyce D. Palomar, *Limited Liability Companies, Corporations, General Partnerships, Limited Partnerships, Joint Ventures, Trusts – Who Does the Title Insurance Cover?*, 31 Real Property. Prob. & T. J. 606, 633-634 (Winter 1997), quoting William D. Bagley, *The Limited Liability Company: A New Entity for the United States*, 65 Okla. Bar J. 1103, 1109 (1994). However, the use of such a strategy may result in problems for the lender, including lender liability and bankruptcy concerns, as described later in this article.

Creditors usually must rely entirely on the LLC’s assets for repayment unless there are separate individual guarantees or credit enhancements by some or all of the members; whether the loan is recourse or not may not matter if no member liability exists. Unlike a general partnership, the lender-borrower documents probably can’t make any member personally liable regardless of the language in the documents (absent specific provisions in the articles of organization or operating agreement and/or a direct and total personal undertaking, e.g., a guarantee by a member). To reach individual principals, the lender must take direct and separate personal obligations from individual members. The absence of a personally liable individual within the standard LLC structure may result in lenders insisting on separate guarantees from a larger group of members.

IV. Title Issues and Considerations

Title practice in connection with LLCs is local; there are no generally promulgated title standards and virtually no case law on title issues affecting LLCs. Connecticut, Oklahoma, and a few other states are considering draft title standards for LLCs. There is still relatively little law in general on LLCs, and title insurers cannot be certain yet how courts will address and decide legal issues that arise under LCC statutes and regulations with respect to the transfer and

encumbering of real property owned or purchased by LLCs. See Joyce D. Palomar, *Limited Liability Companies, Corporations, General Partnerships, Limited Partnerships, Joint Ventures, Trusts - Who Does the Title Insurance Cover?*, 31 Real Prop. Prob. & Tr. J. 606, 636-637 (Winter 1997).

Factors to be taken into consideration by title insurance examiners and underwriters in connection with LLCs are the relevant state statute(s), the articles of organization and the operating agreement of the LLC, and an analogy to partnership and corporation law. If an LLC is the grantor or borrower, the title company must check the existence of the LLC, the authority of the LLC to own and convey real estate, and the authority of the designated individual(s) to sign and deliver the conveyance or mortgage instrument and other related documents. The title insurer will customarily require the following:

- A good standing certificate from the state of organization of the LLC (and, if the LLC is purchasing or mortgaging property in another state, evidence of registration or qualification to do business in the state where the property is located, if and to the extent required by that state). See *Danka Funding, LLC v. Page, Scrantum, Sprouse, Tucker & Ford, P.C.*, 21 F.Supp.2d 465, 473 (D.N.J. 1998) (defendant sought to have the plaintiff LLC's claims dismissed for failing to comply with New Jersey registration requirements applicable to foreign LLCs doing business in New Jersey; plaintiff, which was a New York LLC, had previously been registered but had allowed its registration to lapse but re-registered after the suit was filed; court held that under New Jersey law failure to register did not require dismissal so long as the deficiency was corrected and proper registration was filed during the proceedings);
- A certified copy of the LLC's articles of organization and operating agreement (and all amendments thereto). Affidavits, certificates, or opinions of the LLC's counsel may also be required if the articles of organization are not signed by or don't list the members;
- Verification of the continued existence of the LLC (i.e., no articles or certificates of dissolution, judicial decree(s) of dissolution or similar documents have been filed with respect to the LLC), or verification of the authority of a member, or members, to continue the business of the LLC post-dissolution;
- Review and analysis of the statutes and documents that govern who must sign for the LLC. If management is by the members, every member is an agent whose act binds the LLC if the act is for the apparent purpose of carrying on its usual business and the person dealing with the member had no actual knowledge that the member lacked authority to bind the LLC in that particular matter. (Under some LLC statutes, a specified officer must sign all conveyancing documents);
- In connection with a manager-operated LLC, evidence that the manager has the authority to act for and bind the LLC. If there are multiple managers, the LLC may need to act by majority vote. The apparent authority of one manager may not be enough. In Illinois, § 5-5(a)(5) of the Revised Act provides that the LLC's articles of organization must specifically state which persons, either the members or the managers, will have the authority to bind the company when dealing with third parties. Section 13-5(c) of the Revised Act provides that,

with respect to transfers of real property, any member (in a member-managed LLC) or any manager (in a manager-managed LLC) shall, unless otherwise limited in the articles of organization, have the authority to transfer any real property interest of the company. *See Alpine Bank v. Moreno (In re Moreno)*, 293 B.R. 777, 783-85 (Bankr. D. Colo. 2003) (bank lender's deed of trust was defective and could be avoided as invalid lien by trustee under § 544(a) of Bankruptcy Code, where it was erroneously signed by individual as manager of LLC that did not own the property);

- Further proof of the necessary authority to execute documents may be needed if the conveyance is not in the ordinary course of the LLC's business, disposes of substantially all of the assets or property of the LLC, or makes it impossible to carry on the business of the LLC. Written consents of the members or a specified percentage of the members must usually be obtained in such instances;
- Verification of the incumbency of the members or managers of an LLC. Presently there is no uniform method for verifying such incumbency. The articles of organization should authorize the appointment of an officer with duties similar to a corporate secretary, and state that any person dealing with the LLC can rely on that officer's certificates as to records, incumbency, and proceedings of the LLC;
- If the conveyance is from an out-of-state LLC, a review of the law of the state of formation for requirements with respect to organization, existence, and authority. Currently, all fifty states and the District of Columbia have enacted LLC statutes that permit the qualification of foreign LLCs. Failure to so qualify may render any purported conveyance or mortgage by the foreign LLC invalid. The laws of both states must be checked to determine the classification and treatment of the LLC and its members. If an LLC is conveying, purchasing or mortgaging property in another state, the state where the property is located will recognize limited liability of the members and the existence of the foreign LLC entity. *See Matjasich v. State of Kansas Dept. of Human Resources*, 21 P.3d 985, 989 (Kan. 2001) (holding that law governing foreign LLC included not only LLC Act of LLC's state of organization, but also other laws of that state bearing on member liability because the laws of the jurisdiction of organization govern the internal affairs of LLC and the liability of members; the court stated that "the laws of the foreign jurisdiction include not only the foreign jurisdiction's limited liability company enabling laws but also other laws bearing on member liability");
- Resolution or other appropriate written action by the authorized members and/or manager(s);
- Fictitious name certificate; and
- Proper searches for prior names or change of name, franchise tax liens, judgment liens, and other liens and defects.

A sample form of Certificate of Formation for a Delaware LLC is attached hereto as **Appendix A**. A sample short-form Delaware LLC Agreement is attached hereto as **Appendix B**.

V. Fairway and Additional-Insured Endorsements

If an LLC has obtained an owner's policy of title insurance, a lapse of coverage may subsequently occur because, under most state LLC statutes, the LLC must dissolve when only one member remains or when any member dies, withdraws or becomes bankrupt, insolvent or incompetent. However, under a typical LLC state statute (including the Revised Act), the articles of organization or the operating agreement may nonetheless specifically provide for continuation of the business of the LLC or permit all or a majority of the remaining members to authorize continuation of the business. Under the Delaware Limited Liability Company Act, Del. Code Ann. tit. 6, § 18-101, *et seq.* ("DLLC Act"), a Delaware LLC is dissolved at any time there are no remaining members, provided that the LLC is not dissolved, or required to be wound up, if the LLC is continued by a new member in a manner permitted by the DLLC Act or the LLC operating agreement. *See* Del. Code Ann. tit. 6, §18-801(a)(4).

Under the "Fairway" rule, if less than the statutorily or contractually required number of members decides to reconstitute or continue the business of the LLC, coverage under the LLC's owner's policy may be terminated. This rule was established by the court in *Fairway Development Co. v. Title Ins. Co. of Minn.*, 621 F. Supp. 120 (N.D. Ohio 1985). In this case, the title insurer successfully asserted that when two of the partners in an existing general partnership sold and transferred their interests in the partnership to the remaining partner and a new partner, who then entered into a new partnership agreement with the same partnership name, the original partnership was dissolved under applicable state law. The court held that a new partnership was created when the partnership interests were transferred, and the new partnership thereby created had no insurable interest under the policy with respect to an alleged defect in the partnership's title to the property.

If an LLC is used as an estate-planning vehicle, with the transfer of real property to the LLC, special care must be taken to avoid termination of coverage under the owner's title insurance policy. In *Gebhardt Family Restaurant, L.L.C. v. Nation's Title Ins. Co. of New York*, 132 Md. App. 457 (2000), the court held that a transfer of land from two family members to an LLC, of which they were the only members, terminated coverage under a policy naming the individual family members as the insured parties. The Gebhardts, husband and wife, owned a 31.7-acre parcel of property, upon which they held an owner's title insurance policy. In 1995, they discovered that another party was paying property taxes on 4.75 acres of the property. They submitted a claim to their title insurer, demanding that the insurer correct the situation by "negotiating a purchase from the alleged owner (who also has a cloud on title) . . . and obtaining a quitclaim in favor of [the Gebhardts]." *Id.* at 459. In 1996, before the claim was resolved, the Gebhardts executed, for estate-planning purposes, a special warranty deed conveying all of the property to a Virginia LLC of which they were the sole members. The deed recited a consideration of approximately \$161,000.

In 1997, the Gebhardts sued the title insurer for breach of contract for failing to resolve the title dispute. The sole issue before the court was whether the Gebhardts or the LLC were the insured party under the policy. At the trial, Mr. Gebhardt testified that in fact no consideration changed hands (despite the deed recitation of consideration in the amount of \$161,000), and that the only reason for the deed recitation was so that the State of Maryland could "assess the transfer taxes from the individual to the L.L.C." *Id.* at 460. The Maryland appellate court stated

that “there is no dispute” that the Gebhardts did not remain insureds under the title policy by virtue of a purchase money mortgage or by virtue of covenants of warranty. *Id.* at 462. (Paragraph 2 of the Conditions and Stipulations of the standard ALTA owner’s title insurance policy provides that coverage under the policy continues if the insured retains an estate or interest in the land, holds a purchase money mortgage from the purchaser, or retains continuing liability by reason of deed covenants of warranty). The Gebhardts had also conceded, at oral argument before the appellate court, that the LLC had not acquired title by “operation of law.” (The policy definition of “insured,” as set forth in Paragraph 1(a) of the title policy Conditions and Stipulations, includes “those who succeed to the interest of such insured by operation of law as distinguished from purchase”).

The Gebhardts argued that they nonetheless remained insured parties under the title policy because the conveyance was, in effect, to themselves, and therefore they still retained an “interest” in the property. However, the appellate court ruled that “[i]n contrast to a partnership, a limited liability company in Virginia is an entity separate from its members and, thus, *the transfer of property from a member to the limited liability company is more than a change in the form of ownership; it is a transfer from one entity or person to another* (emphasis in text) (citation omitted).” *Id.* at 463. The court held that while the Gebhardts had an interest in the LLC (which was a personal property interest), they no longer had an interest in the real property as the result of their conveyance of the property to the LLC. The court also rejected the Gebhardts’ claim that there was no “real” conveyance because the LLC in fact paid no consideration, ruling that the conveyance to the LLC provided the Gebhardts with actual and substantial benefits, including limited liability and estate planning benefits. The court found that the Gebhardts’ argument was “circular,” i.e., a valid conveyance had occurred because a transfer tax is imposed on the transferring of property and if there had not been a conveyance, no transfer tax would have become due.

The court also noted that as the result of conveying by special warranty deed, the Gebhardts covenanted to protect the LLC only against claims made “by, through, or under” the Gebhardts, as grantors, and did not warrant title against someone else. Therefore, the court held, the Gebhardts had transferred to the LLC the unresolved title claim, and the LLC became the proper party to defend any action by another party to quiet title (with no recourse against the Gebhardts as grantors). Finally, the appellate court rejected the Gebhardts’ assertion that they had suffered a loss under the policy, and reported it to the title insurer, before the conveyance to the LLC. The court noted that the Gebhardts had admitted in their appellate court brief that no actual loss had yet occurred. The court held that because of the conveyance to the LLC, which was a legally distinct entity, any subsequent loss would be the LLC’s loss, which entity was not the insured party under the title policy either before or after the conveyance.

In *Point of Rocks Ranch, LLC v. Sun Valley Title Ins. Co.*, 146 P.3d 677 (Idaho 2006), the appellants, John and Elaine French (“Frenches”), purchased a parcel of real estate and obtained title insurance for the property from Commonwealth Land Title Insurance Company (“Commonwealth”). They later deeded the property to Point of Rocks, LLC, an Idaho LLC that they owned. The warranty deed to the property was expressly made subject to easements of record, and was recorded on February 15, 2002. In April, 2002, the Frenches discovered for the first time that the United States of America had obtained an easement across the property, and that the easement had been properly recorded in 1954 (which easement apparently was not

shown in the title policy). The easement was for the purpose of providing access to water by livestock grazing on the adjoining public lands. The Frenches made a claim under their title insurance policy with Commonwealth, which Commonwealth rejected. The district court granted judgment in favor of Commonwealth, and Commonwealth appealed. The Idaho Supreme Court affirmed the judgment of the district court, finding that coverage under the Frenches' title policy terminated in February 2002, when they conveyed the property to their LLC. According to the appellate court, "As of that date, the Frenches no longer had an estate or interest in the land, and their limited liability company had not granted the Frenches a purchase money mortgage." *Id.* at *4. The court noted that because the warranty deed to the property expressly excluded any easements, the Frenches did not have any liability for any breach of deed covenants. The appellate court rejected the contention of the Frenches that since they had a claim (though unknown) while they owned the property, they should still be permitted to recover damages under the title policy. The court held that because the Frenches had conveyed the property to their LLC before they had discovered the easement and made a claim under the policy, they were not entitled to recover under the policy. The court also rejected the Frenches' claim that the coverage provided under the policy was "illusory," finding that the policy (with a liability amount of \$3,500,000) provided coverage for the entire time that the Frenches owned the property (and even after the sale, if the warranty deed had not excluded easements from the warranty covenants). The court further rejected the Frenches' argument that the LLC was an insured party under the title policy because it obtained title to the property by operation of law. The court found that the Frenches had conveyed the land to the LLC by a properly recorded warranty deed, thereby negating any transfer by operation of law.

See also Covalt v. First American Title Insurance Co., 105 F.3d 669, 1997 WL 4273 (10th Cir. Jan. 7, 1997) (unpublished disposition) (ruling that transfer of real property, by quitclaim deed, from individual to trust in which individual retained an interest, prevented trust from claiming any rights under the title insurance policy originally issued to individual); *Simmons v. Reiner*, Ohio. 1999 App. LEXIS 5783 (Oh. App. Dec 3, 1999), at *10 (holding that dower interest of husband, who had quit-claimed insured real property to his wife, was a contingent claim which "is not a marketable estate or interest" that would entitle him to coverage under title policy; and further holding that no loss had been incurred under the title policy until after title had been transferred); *General Medicine, P.C. v. Metropolitan Title Co.*, Mich. App. Ct. No. 216012 (March 2, 2001) (unpublished) (ruling that where plaintiff had conveyed property by quitclaim deed before discovering easement that burdened property, it had no standing to sue under title policy because conveyance was absolute and plaintiff had not retained any title interest); *Bengeyfield v. First American Title Ins. Co.*, 2005 Mich. App. LEXIS 2116 (Mich. App. Ct. August 25, 2005) (holding that where individual land contract vendees conveyed their interest to trust and land contract vendor later conveyed warranty deed to trust, original individual vendees did not have insurable interest in land and could not assert claim under title policy); *Chicago Title Ins. Co. v. 100 Investments L.P.*, 2004 U.S. App. LEXIS 920 (4th Cir. Md. Jan. 22, 2004), at *10 (stating that defendant "gave a special warranty [deed], promising only that [defendant] had not itself created any defect in title – a warranty whose breach would be specifically excluded from coverage. At the point of conveyance . . . any preexisting defect in title became [the grantee's] problem and [the grantee] would have to obtain its own title insurance to protect itself from any problem that might be caused by that defect" (citing *Gebhardt, supra*)); *Ask Realty II Corp. v. First Am. Title Ins. Co.*, 2004 WL 1254005 (D. Md., June 7, 2004), at *5 (stating that "[a] special warranty of title is breached only if the grantor's

own conduct during its period of ownership creates a claim against the title,” and holding that alleged breach of special covenant against encumbrances without establishing that grantor itself created or knowingly allowed an encumbrance on the property would prevent coverage under title policy); *Chicago Title Ins. Co. v. 100 Investments L.P.*, 355 F.3d 759, 763 (4th Cir. 2004) (“[i]f a preexisting defect in title were to remain after the insured conveyed the land [by special warranty deed], the risk inherent in that defect would pass to the purchaser and the insured would no longer have risk, nor coverage [under the title policy]”); *Butera v. Attorneys’ Title Guaranty Fund, Inc.*, 321 Ill. App. 3d 601, 607, 747 N.E.2d 949, 954 (2001) (holding that a deed from a trust to corporation, whose shareholders were the sole beneficiaries of the trust, was a transfer by purchase and not a transfer by operation of law that would provide continuing coverage under the owner’s title policy originally issued to the trust); *Gray v. First American Title Ins. Co.*, 2003 Cal. App. Unpub. LEXIS 1163 (March 4, 2003), at *7-8 (ruling that because insured individuals had transferred title to property to partnership consisting of themselves and another individual, previous claim they may have had against title insurer before conveyance was not preserved, and stating that, “[the new partnership] is not an insured under the policy and may not be deemed an insured here”); *Austin v. City of Alexandria*, 265 Va. 89, 95-96 (2003) (holding that deed to trustee effects change in ownership of property even if grantor, trustee, and beneficiary are same person and beneficiary has complete power to revoke trust’); *Pioneer Nat’l Title Ins. Co. v. Child, Inc.*, 401 A.2d 68, 70-71 (Del. 1979) (holding that the term “operation of law,” for purposes of coverage under title policy, indicates the manner in which a person acquires rights without any voluntary act of his own); NY CLS LLC § 203(d) (2003) (“[a] limited liability company formed under this chapter shall be a separate legal entity . . .”). Cf. *Redmond v. Kester*, 2007 WL 1649931 (Kan. Sup. Ct., June 8, 2007) (affirming Kansas statute providing that “any transfer by warranty deed into an inter vivos trust shall not affect the coverage of any title insurance if the settlor of such trust is and remains a beneficiary of such trust during the settlor’s lifetime,” even though statute required warranty deed and conveyance was by quitclaim deed); *Mississippi Valley Title Ins. Co. v. Malkove*, 540 So.2d 674, 678 (Ala. 1988) (holding that conveyance of land by tenants in common to partnership of which they were partners did not terminate title policy since they continued to retain an estate or interest in the property). Note: If the grantee purchases the 1998 ALTA EAGLE Homeowner's Policy of Title Insurance (10-17-98), the title insurance coverage under the policy will not terminate when the insured dies or transfers title to a trust; however, this policy does not cover transfers to an LLC.

Standard title insurance policies define an “insured claimant” as an “insured” claiming loss or damage. See ALTA Owner’s Policy, Conditions & Stipulations, par. 1(b) (Oct. 17 1992). Therefore, as noted in the cases described above, the title insurer will likely reject a claim by a party who is neither the insured named on Schedule A nor a “successor” thereof by “operation of law.” See *Shotmeyer v. New Jersey Realty Title Ins. Co.*, 2007 WL 283661 (N.J. Super. A.D. (Feb. 2, 2007) (Unpublished), in which the title company issued an Owner’s Policy of title insurance to Henry and Charles Shotmeyer, d/b/a Beaver Run Farms, a general partnership. Several years later, the Henry and Charles, for estate-planning purposes, transferred the property (for nominal consideration) to a limited partnership in which they were the sole limited partners and a corporation they controlled was the sole general partner. A claim against a neighboring landowner later arose under the policy, which claim was submitted to the title insurer. The trial court held that coverage terminated upon the transfer to the limited partnership.

The appellate court reversed the holding of the trial court, stating initially that title insurance policies are to be “liberally construed in favor of the insured and strictly construed against the insurer.” *Id.* at *3 (citation omitted), and must reflect the “reasonable expectations” of the insured and “should not be subjected to technical encumbrances or to hidden pitfalls.” *Id.* The court reasoned that it was not appropriate to focus on whether the transfer was by operation of law but rather that on the facts of this case, and “there was never a transfer of the Shotmeyer brothers’ beneficial interests in the lands the title insurance policy was procured to protect.” The court also concluded that “Beaver Run Farms, L.P., though it is a distinct legal entity, is not a stranger to the title insurance policy,” *Id.* at *4, being comprised of the same individuals and a corporation of which they were the sole shareholders. The court stated that “In short, the general partnership and the limited partnership are no more than alter egos of Henry and Charles Shotmeyer.” *Id.* The court also found it “critical that although the brothers changed the form of their ownership, they never relinquished control and never diluted their personal interests in the property that is the principal, if not sole, asset of the artificial entities they formed to hold title.” *Id.* The court concluded that, “Where there was no change of substance, there was no reason for Charles and Henry to expect that the title insurance company would not recognize their continued ownership of the property.” *Id.* The court noted that Charles and Henry did nothing to adversely affect title to the property or increase the burden or risk of the insurer. The court did hold, however, that the insurer did not waive the right to contest coverage by offering to settle the dispute, particularly since the insured rejected the offer. The court in this case relies virtually entirely on the equitable principle of the “reasonable expectations” of the parties instead of the contractual language of the title policy, and its “alter ego” theory is directly contrary to the holding in the *Gebhardt* case, *supra*, and the numerous other similar rulings cited and discussed above.

The appellate court’s decision was, unsurprisingly, overruled by the New Jersey Supreme Court in *Shotmeyer v. New Jersey Realty Title Ins. Co.*, 2008 WL 2355781 (N.J., June 5, 2008). The New Jersey Supreme Court held that the title insurance policy obtained by the general partnership when it purchased the property lapsed when the property was voluntarily conveyed to the separate and distinct limited partnership formed by the same individuals, and the limited partnership did not have standing to sue under the policy. The court found that the Shotmeyer brothers: 1) did not have an insurable interest in the property at the time of the loss; 2) the fact that the brothers maintained beneficial ownership of the property both before and after the conveyance did not allow them to recover under the title insurance policy; 3) the transfer of the property from the general partnership to the limited partnership did not occur by operation of law; 4) the covenant as to grantor’s acts in the deed conveying the property to the limited partnership did not entitle the general partnership to continuing coverage under the policy; and 5) the insurer’s offer to settle the brothers’ claim did not constitute a waiver of the insurer’s defense that the policy lapsed.

Only one other decision, *Heyden v. Safeco Title Ins. Co.*, 175 Wis. 2d 508, 517-18 (Dist 1, 1993) (overruled in part by *Weiss v. United Fire & Cas. Co.*, 197 Wis. 2d 365 (1995)), citing general property and casualty insurance cases, has held that the sole shareholder of a corporate insured had an insurable interest under the title policy covering the corporation as the insured party, and was a proper party plaintiff to bring an action against the title insurer for bad faith. The court so held even though the shareholder lacked legal or equitable title to the property and the corporation, and not the shareholder, was named as the “insured” in the policy’s Schedule A.

The court held that the shareholder's "reasonable expectations of loss" sufficed to give him an insurable interest and make him a proper party to bring suit, along with the shareholder, against the corporation and against the title insurer. *See also Estate of Plautz by Pagel v. Time Ins. Co.*, 189 Wis. 2d 136, 146 (1994) ("*Heyden's* requirement that a non-named-insured have an insurable interest in the subject of the insurance policy in order to be a proper party to a lawsuit is consistent with our real-party-in-interest analysis"). But as noted above, the ruling by the appellate court decision in *Shotmeyer v. New Jersey Realty Title Ins. Co.*, *supra*, was recently overturned by the New Jersey Supreme Court, and the *Heyden* decision, on the issue of who is an insured under policy of insurance, has not been followed in any other jurisdictions.

It may seem, at first blush, that the Gebhardts may have avoided a loss of title coverage for the LLC by conveying the property by a full warranty deed instead of by special or limited warranty deed. However, in many jurisdictions recovery under warranty deed covenants is limited to the consideration the grantors actually received, i.e., the measure of damages for breach of warranty is limited to such an amount; therefore, no title insurance coverage would exist where there is no actual consideration. Even if valid consideration for the deed were established, the successor LLC would be required to assert a claim against the grantors for breach of the deed covenants in order to trigger the title company's obligation to defend and indemnify. The insured grantors could easily become offended at the prospect of becoming involved in a legal action, with depositions and interrogatories, filed against them by family members to whom they intended to convey a valuable benefit.

A more prudent course of action for an LLC, to which real property has been transferred as part of an estate plan, may be to obtain a new owner's title policy at the time of the conveyance. The LLC would clearly become the insured party, the status of title would be identified and insured through the date of closing, the validity of the transfer would be insured, and the property would be insured for its current value. However, obtaining a new owner's policy may be expensive (although a reissue rate may apply). If the LLC procures a new owner's policy, it should request a "non-imputation" endorsement from the title insurer if the grantee LLC contains members other than the original grantors. This will prevent any subsequent denial of coverage by the title insurer based on policy defenses for matters "created, suffered, assumed or agreed to" by the insured and for matters not available in the public records or known only to the insured and not to the title company. Sample forms of LLC non-imputation title endorsements are attached hereto as **Appendix C** (which provides assurance that the title insurer will not deny coverage under the policy based on matters known to an outgoing member being imputed to an incoming member by operation of law) and **Appendix D** (which provides assurance that the title insurer will not deny coverage under the policy based on matters known to the insured LLC being imputed to a new member). A sample form of non-imputation affidavit (which would be executed by all of the current members of the LLC) is attached hereto as **Appendix E**.

The best solution may be for the grantee LLC to request an "additional insured" endorsement from the title insurer (in those jurisdictions where it is available), which would be effective as of the date of the conveyance. This endorsement specifically amends the existing owner's policy to add the LLC as a named insured. The cost of the endorsement is usually nominal (\$100 to \$300) and many title insurers will routinely issue the endorsement for successor LLCs as well as for trustees for inter vivos trusts, who are acquiring title from the insured owner(s). The title insurer will want to satisfy itself that, from an underwriting standpoint, no greater risk will occur as the

result of the transfer. However, the coverage provided by the additional insured endorsement is no greater than that provided under the original policy, and is subject to all the defenses available to the title insurer under the original policy. For example, there is no protection for the additional insured if the conveyancing deed is itself defective.

Under the new 2006 ALTA Owner's and Loan policies the definition of "Insured" contained in Condition 1(d) (in the 2006 Owner's Policy) and Condition 1(e) (in the 2006 Loan Policy) has been expanded and is a significant improvement over the 1970 and 1992 ALTA Policies. A policy of title insurance protects, for the most part, only the named Insured in the policy. Under the 1970 and 1992 Policies, with little exception, those who succeed to the interest of the property by operation of law, as opposed to voluntary conveyance, also fall within the definition of "Insured." However, determining what is a voluntary transfer, as opposed to a transfer by operation of law, has resulted in substantial confusion and uncertainty. The new definition for "Insured" in the 2006 Owner's and Loan Policies more clearly defines the term "Insured" and recognizes as an Insured, among other entities or persons not addressed in the 1970 and 1992 Policies, certain "voluntary" conveyances by the named Insured that are made without receipt of valuable consideration, including, in the Owner's Policy, where the grantee is the trustee or beneficiary of a trust established by the named Insured for estate-planning purposes.

When buying title insurance, the LLC should also consider requesting a Fairway type of endorsement, protecting against any lapse of coverage resulting from a change in the membership of the LLC or from any resulting dissolution. However, title companies may be understandably reluctant to issue such an endorsement because the law regarding LLCs is not as clear-cut as the law regarding partnerships, and even if they are willing to issue this type of endorsement it may provide assurance only if the dissolution or change in composition of the LLC does not result in the LLC being dissolved or discontinued under applicable state law. The title company would also need to carefully analyze the articles of organization and the operating agreement of the LLC when deciding whether to issue a Fairway endorsement and, if issued, the form of such endorsement. There is no standard form and the Fairway endorsement, if available at all, must be negotiated on a case-by-case basis with the title insurer. There is likely to be a charge for such an endorsement. A copy of a sample Fairway endorsement for use in connection with LLCs (which may not be available in all jurisdictions) is attached hereto as **Appendix F**. This endorsement provides that the title insurer will not deny coverage under the policy issued to the LLC based on either of the following events: (1) the admission, substitution, or withdrawal of any individual or entity as a member in the insured LLC, or (2) a change in any member's interest in the capital or profits of, or a managing or non-managing member in, the insured LLC where, under the circumstances of the operating agreement of the insured LLC (as amended and restated) the business of the insured LLC continues after such event.

It should be noted that many states have recently enacted "conversion" statutes, which permit transfers from existing legal entities, such as general and limited partnerships, to LLCs. These statutes generally provide that the entity that has been converted remains for all purposes the same entity that existed before the conversion. *See, e.g.*, Del. Code Ann. tit. 6, § 18-214(f); ILCS 180/37-15; MCL 450.4707. Such a statutory conversion does not result in a conveyance of property and is considered merely a "name change." This statutory language would support the position that a "transfer or conveyance of such estate or interest" has not occurred within the meaning of paragraph 2 of the ALTA title policy's Conditions and Stipulations. Furthermore,

the successor LLC would be deemed an “insured,” as defined in the policy, because it would “succeed to the interest of such [original] insured by operation of law as distinguished from purchase.” See Robert R. Nix II, *Capturing the Benefits of the Limited Liability Company: Use of Transfers, Conversions, Mergers and Legislated Enhancements*, The ACREL Papers 2000, American College of Real Estate Lawyers Annual Meeting, Boston, Massachusetts, Oct. 12-14, 2000, at Tab 13.

Whether an existing entity has been “converted” into an LLC may also affect whether the transferring entity may claim an exemption from the imposition of transfer taxes when real property owned by the converting entity is conveyed to the LLC. In *Exton Plaza Associates v. Commonwealth of Pennsylvania*, 763 A. 2d 521 (Pa. Cmwlth. 2000), a refinancing lender required that the shopping center owned by the borrower, a general partnership, be transferred to a “single purpose and bankruptcy remote entity” as a condition to obtaining the loan. The general partnership converted itself into a limited partnership of the same name, with each of the two general partners owning a 49.5 percent interest as limited partners in the new limited partnership. A new LLC, of which each of the original partners owned a 50 percent interest, was created to own a one-percent interest as the general partner of the new limited partnership. (The refinancing lender’s loan commitment prohibited either of the individual general partners from serving as general partner in the new entity). The deed from the general partnership to the limited partnership recited a consideration of \$1.00 and claimed a full exemption from payment of the Pennsylvania transfer tax, stating on the deed that, “Principals of grantor and grantee are one and the same.” The Commonwealth Court of Pennsylvania upheld the claim of exemption, finding that the deed in this case did not meet the statutory definition of “document” because it did not convey an interest to someone other than the grantor, i.e., it was merely a “name change” and “did not effect a meaningful transfer of title.” *Id.* at 523. The court reasoned that the general partnership had merely “converted” to the limited partnership, transferring a one- percent interest to an LLC as the general partner. The court stated that, “the shopping center was essentially ‘contributed’ to the Limited Partnership, and the principals’ property rights in the shopping center were essentially unchanged.” *Id.* at 524.

In Illinois, 805 ILCS 180/37-15 of the Revised Act provides that the effect of a conversion of a general partnership or a limited partnership to a limited liability company is that the entity is unchanged. At the time the conversion takes effect, “all property owned by the converting partnership or limited partnership vests in the limited liability company.” 805 ILCS 180/37-15(1). The LLC is considered “for all purposes” as the same entity that existed before the conversion, and “all of the rights, privileges, immunities, powers, and purposes of the converting partnership or limited partnership vest in the limited liability company.” 805 ILCS 180/37-15(4). Furthermore, “all of the partners of the converting partnership continue as members of the limited liability company.” 805 ILCS 180/37(5). It is unclear whether an Illinois court would hold, similar to the Pennsylvania court’s ruling in *Exton Plaza Associates, supra*, that a deed from a partnership to an LLC (at least in those situations where the same individuals or entities that were the partners of the converting general or limited partnership continued as members of the new LLC) would not be subject to Illinois’ statutory transfer tax.

With respect to Illinois LLC mergers, 805 ILCS 180/37-20 provides that an LLC “may be merged with or into one or more limited liability companies, foreign limited liability companies, corporations, foreign corporations, partnerships, or other domestic or foreign entities if merger

with or into a limited liability company is permitted under the law governing the domestic or foreign entity.” When the merger takes effect, the separate existence of each LLC and other entity (other than the surviving entity) terminates. 805 ILCS 180/37-20(1). Similar to the Illinois statutory provisions regarding partnership conversions to LLCs (see the preceding paragraph), all property owned by the each of the LLCs and other entities that are party to the merger vests in the surviving entity, and “all the rights, privileges, immunities, powers, and purposes of every limited liability company and other entity that is a party to a merger vest in the surviving entity.” 805 ILCS 180/7-20(2) and (5). Under another Illinois statute, enacted in 2001, limited partnerships may merge with or into one or more other limited partnerships or limited liability companies wherever located, i.e., the merger may be into or with any such other entities organized in Illinois or in any other state or the District of Columbia, if the laws of the other state or states or the District of Columbia permit the merger. *See* 805 ILCS 210/210.

On July 25, 2002, Illinois’ Gov. Ryan signed Public Act 92-0740 (the “Act”), Illinois’ version of the Uniform Partnership Act (1997) (“RUPA”). Illinois has joined over 30 states that have adopted RUPA. Section 909 of the Act permits conversions of partnerships into limited liability companies and Section 908 addresses mergers of partnerships and limited liability companies.

In connection with a conversion of a corporation to an LLC, one tax commentator has stated that “the principal methods [of conversion] are the contribution of all the stock to a newly formed L.L.C. in exchange for L.L.C. interests, followed by the liquidation of the corporation up to the L.L.C. shareholder; the liquidation of the corporation, followed by recontribution of the assets and liabilities to the new L.L.C.; a merger, with the L.L.C. surviving; and statutory conversion-election in those few states, such as Georgia, that permit it for corporations.” John F. Walker, Jr., *Taxation*, The National Law Journal, June 3, 1996, at 84.

VI. Mezzanine Financing Endorsements

As a result of the increased securitization of real estate and the packaging of pools of loans for sale into the secondary market, mezzanine financing has become very popular in recent years. Mezzanine financing (or, perhaps more appropriately, mezzanine capital) fills the gap between the first mortgage financing, which usually has a loan-to-value ratio of forty to seventy-five percent, and the equity participation of the principals of the borrower, which is usually no more than ten percent of the cost of the project. Mezzanine financing commonly supplies financing of ten percent to fifty percent of the project’s capital structure cost. This type of financing can take several forms. Most commonly, it involves extending credit to the partners or other equity holders of a borrower and taking a pledge of such parties’ equity interests (including the right to distributions of income). Alternatively, the lender may take a preferred equity position, which is entitled to distributions of excess cash flow after debt service, ahead of the borrower’s principals. A “combination” loan structure may also be used to combine a first mortgage loan with mezzanine financing at an aggregate loan-to-value ratio of ninety to ninety-five percent. This type of structure may contain a shared appreciation or contingent feature, an exit fee paid by the borrower, or sometimes, both.

The borrower in a mezzanine loan is often an LLC, and the equity participant in the borrowing entity is frequently itself an LLC. In those situations where the mezzanine lender is taking a pledge of some or all of the equity interests in one or more of these entities in connection with the mezzanine loan, the lender may look to the title insurer for special forms of title-insurance coverage. The lender may seek some form of non-imputation coverage, i.e., assurance that the title insurer will not deny coverage under the owner's policy based on matters known to the borrowing entity (or its members) being imputed to the lender. Copies of endorsements offering this type of coverage are attached hereto as **Appendix G, Appendix H, and Appendix I.**

Title underwriters may require an affidavit and an indemnity agreement from the existing LLC members, and from the mezzanine lender when it exercises its foreclosure rights under the pledge and succeeds to an ownership interest in the mezzanine borrower. These affidavits and indemnity agreements will state that the respective parties have no knowledge of any fact that will affect the coverage under the policy, and will hold the title insurer harmless for losses resulting from its reliance on such affidavits and indemnities. The title insurer may also require, and review, financial statements from all relevant parties in order to achieve a comfort level for relying on the aforementioned indemnity.

The endorsements attached as **Appendix G, Appendix H, and Appendix I** state that (as agreed to by the insured and its equity members) all payments for loss under the policy will go directly to the mezzanine lender, and that there will be no denial of coverage as the result of the transfer of any of the LLC membership interests to the mezzanine lender. The endorsements further provide that the title insurer waives its right of subrogation and indemnity against any of the insured owner's equity owners until the mezzanine loan is paid in full. If a loss occurs under the policy, the amount paid by the title insurer is limited to the actual loss less a percentage thereof equal to the percentage of LLC membership interests not owned by the mezzanine lender at such time. If the loss occurs before the mezzanine lender's acquisition of the insured owner's membership interests, the mezzanine lender is not required first to pursue its remedies against other collateral. However, the title insurer's liability in any event is limited to the amount of the mezzanine loan, and the title insurer is entitled to credit for any amount paid out under a simultaneous loan policy. The title insurer is also entitled to reimbursement from payments received by the mezzanine lender from other security. The term "mezzanine lender" can be defined to include the owner of the mezzanine loan and each successor in interest in ownership of the mezzanine loan, and include any subsidiary or affiliate entity of the owner of the mezzanine loan. The availability and content of the endorsements attached as **Appendix G, Appendix H, and Appendix I** will vary depending on factual and underwriting considerations, as well as statutory and regulatory restraints in certain states.

In October, 2003, the ALTA adopted Endorsement Form 16 (Mezzanine Financing). This endorsement is designed for use with new Owner's Policies where the equity interests (one-hundred percent or some lesser percentage) in the insured entity are being pledged as security for a mezzanine loan or as security for a guaranty by the equity holders of some other indebtedness (which may be a loan secured by a mortgage against the subject real estate owned by the vestee entity for which an ALTA Loan Policy may be issued to the "senior" mortgage lender). Since the real value of the equity holder's interest in the entity is based upon the ownership by that entity

of the subject real estate (particularly in the context of so-called “single purpose” or “special purpose” entities so prevalent today in commercial real estate development and financing), the mezzanine lender wants to make sure there is an Owner’s Policy in place insuring the vestee entity’s ownership of the title free of undisclosed liens and other defects and that the mezzanine lender has rights under that Owner’s Policy to any payments otherwise payable to the insured entity. This endorsement in effect provides non-imputation, additional insured, and “Fairway” coverage to the mezzanine lender (these coverages typically are not included in Owner’s Policies). The Form 16 Endorsement protects the mezzanine lender with respect to (1) matters created, suffered, assumed or agreed to by the insured (Exclusion 3(a) of the Owner’s Policy), (2) matters known to the insured but not found in the public records and not known or disclosed to the title insurer (Exclusion 3(b) of the Owner’s Policy), and (3) loss the insured suffers because it has not paid value for the interest in the land covered by the policy (Exclusion 3(e) of the Owner’s Policy). The Form 16 Endorsement assigns to the mezzanine lender the right to receive payments otherwise payable to the insured under the policy and, for that reason, the endorsement requires the signature of an authorized representative of the insured entity consenting to the assignment to the mezzanine lender of any loss payable under the Policy (to the extent of the mezzanine lender’s interest). The Form 16 Endorsement can be issued when the mezzanine loan is closed or it can be issued to amend the borrower’s existing Owner’s Policy. The endorsement also assures the mezzanine lender that no amendment of the policy can be made without its written consent, and includes a “standstill” provision with respect to the title insurer’s right of subrogation against the insured, the borrower, or a guarantor of the mezzanine loan. The Form 16 Endorsement could be issued in connection with an existing Owner’s Policy, but no coverage would be provided for any matters created subsequent to the original policy date. The Form 16 Endorsement is not available in all states, and mezzanine lenders should consult with their title underwriters regarding availability (and pricing).

In addition to the Form 16 Endorsement, many mezzanine lenders obtain a UCC insurance policy (offered by some of the largest title insurance companies, and described below) in connection with mezzanine financing transactions, with appropriate endorsements to insure the attachment, perfection and priority of the lender’s secured interest in the pledged equity interests under the Uniform Commercial Code as adopted in a particular state. (The Form 16 Endorsement does not provide this type of coverage for personal property interests.) A copy of the new Form 16 is attached hereto as **Appendix J**.

As noted above, mezzanine financing often involves extending credit to equity holders of an LLC, with the lender taking a pledge of the parties’ equity interests in the LLC. Under § 9-102(a)(49) of revised Article 9 (“Revised Article 9”) of the Uniform Commercial Code (“UCC”) (which was enacted into law in Illinois in 2001, at 810 ILCS 5/9-101 *et seq.*, and became effective as of July 1, 2001), these types of assets can be either “investment property” or “general intangibles”. Investment property is defined, under § 9-102(a)(49), as a security (whether certificated or uncertificated), security entitlement, securities account, and commodity account or commodity contract. A security interest in investment property may be perfected by control, by filing, or, if the investment property is a certificated security, by possession. *See* UCC §§ 8-301, and §§ 9-313(a) and 9-328 of Revised Article 9. Under § 9-102 (a)(42) of Revised Article 9, general intangibles are defined as personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or

other minerals before extraction. The term includes a “payment intangible” (defined in § 9-102(a)(61) of Revised Article 9 as “a general intangible under which the account debtor’s principal obligation is a monetary obligation”) and software. In essence, “general intangibles” is the residual category of personal property that is not included in the other defined types of collateral. A security interest in a general intangible is perfected by filing. *See* § 9-310 of Revised Article 9.

In order to have a priority security interest in the pledged collateral that will prevail over purchasers, other lenders, and creditors using judicial process to obtain a lien on the collateral, the mezzanine lender must perfect its interest in the collateral. *See* § 9-308(a) of Revised Article 9. As stated above, perfection of a security interest in a pledge of an interest in an LLC can be accomplished by (i) filing a UCC-1 financing statement in the appropriate jurisdiction (under § 9-310 of Revised Article 9, if the security interest is deemed a general intangible or is investment property); (ii) taking possession of the collateral (under § 9-313(a) of Revised Article 9, which also provides that a perfected security interest in certificated securities may be obtained by taking delivery of the certificated securities under UCC § 8-301); or (iii) control (under § 9-314(c) of Revised Article 9, if the security interest is deemed investment property). While the general rule is that the earlier of the first to file or perfect has established priority, perfection by control will prime a security interest in the same property that is perfected by any other method of perfection, even if the control occurs after the time of first perfection. *See* § 9-328(1) of Revised Article 9. Section 9-331(b) of Revised Article 9 also makes explicit what was implied under former Article 9 and is explicit under Article 8, i.e., where investment property collateral is transferred to a person protected under UCC Article 8, Article 9 defers to the rights of protected purchasers under Article 8, to the extent Article 8 provides rights to those protected persons. *See* § 9-331 of Revised Article 9. Thus, although perfection by filing is available, to the extent possible lenders should always seek to perfect their interests in pledges of LLC membership interests by control.

If the governing documents of an LLC provide that the membership interests are securities, then such interests will be treated as securities instead of general intangibles. If an issuer thus opts into Article 8, the lender’s interest in the collateral is deemed investment property and the lender can obtain “Protected Purchaser Status” under UCC § 8-303. A lender has “Protected Purchaser Status” when it gives value for the interest without notice of any adverse claim and has control of the security. Protected Purchaser Status will enable the lender to defeat any adverse claim, including claims of third parties that treat their interests as general intangibles and who perfect by filing in the jurisdiction in which the debtor is located. An example of an amendment to an Operating Agreement for an LLC that contains the necessary language to opt into Article 8 is attached hereto as **Appendix K**. An example of an “acknowledgment and consent” from the issuer evidencing its intent to “opt in” to Article 8 is attached hereto as **Appendix L**.

The issuer’s counsel should be cognizant of the effect of opting into Article 8 and be careful to follow the mandates required within Article 8. For example: (i) § 8-202 requires the issuer to set forth the terms of the security on the certificate or to incorporate them by reference; (ii) § 8-204 requires the issuer to conspicuously note restrictions on transfer on the security certificate or, if uncertificated, to notify the registered owner; (iii) § 8-205 provides, under certain circumstances, for the effectiveness of unauthorized signatures; (iv) § 8209 provides that a lien

in favor of an issuer is effective against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate; (v) § 8401 sets forth the requirements under which an issuer shall register a requested transfer of a certificated or uncertificated security; and (vi) § 8404 provides criteria for holding the issuer liable for wrongful registration.

Section 9-106 of Revised Article 9, by reference to UCC § 8-106, provides that a secured party takes control of an uncertificated security, such as a pledge of an uncertificated LLC membership interest, “if either it is delivered to the purchaser or the issuer agrees in a written agreement to follow the written instructions of the purchaser without further consent by the registered owner.” Delivery will occur, under UCC § 8-103, when the issuer registers the purchaser (i.e., the lender), or a third party not closely related to or controlled by the debtor -- other than a securities intermediary -- who holds on behalf of the lender, as the registered owner. An example of a control agreement entered into by the borrower, the lender and the pledgor, acknowledging an uncertificated pledge of the pledgor’s LLC membership interest to the lender, is attached hereto as **Appendix M**.

Control of a certificated security occurs when the lender or a third person not closely connected to or controlled by the debtor has possession of the certificate, and when the certificate is (i) issued in bearer form, (ii) is issued to the debtor as owner with an endorsement in blank, or (iii) the lender has an assignment separate from the certificate signed in blank by the debtor. *See* § 9-106 of Revised Article 9 and UCC § 8-106. *See also* Steven O. Weise, Philip Ebeling, Dena M. Cruz, Theodore H. Sprink, and Randall L. Scott, *It’s Time to Take a Close Look at UCC Article 9*, 19 Cal. Real Prop. J. 3, 7-8 (2001).

According to one commentator, “A lender requiring an opt-in should take steps to prevent the issuer from opting out of Article 8 at a later time [by entering into in an agreement with the issuer that it will not opt out and requiring that the LLC operating agreement provide that the language opting in to Article 8 cannot be amended without the lender’s consent]. A lender that does not require an opt-in should take steps to prevent an opt-in [by entering into an agreement with the issuer that it will not opt in under Article 8 or amend the LLC operating agreement to permit an opt-in without the lender’s consent].” Lynn A. Soukup, “*Opting In*” to Article 8 – *LLC, GP & LP Interests as Collateral*, Commercial Law Newsletter, American Bar Association Section of Business Law (July 2002), at p. 1. *See also* Lynn A. Soukup, *LLCs, Partnerships and the UCC*, 14 Bus. Law Today 53 (January/February 2005).

First American Title Insurance Company offers the EAGLE 9™ UCC Insurance Policy (“EAGLE 9 Policy”). (Similar products are also offered by certain other major title insurers). The basic EAGLE 9 Policy insures the proper creation, attachment, perfection (whether by filing, possession, or control), priority and effectiveness of UCC security interests. First American has also promulgated, in connection with the EAGLE 9 Policy, a specialized endorsement for use in connection with mezzanine loans. Remarkably, if the governing documents of an LLC provide that the membership interests are securities and the lender has taken the proper steps to achieve Protected Purchaser status (as described above), this endorsement insures not only perfection by possession or control, but also that the pledgor owns the interests being pledged as collateral. A copy of the endorsement is attached hereto as **Appendix N**.

VII. Recharacterization and Usury Issues

Title insurance companies are not likely to accede to a request to issue an endorsement insuring against the recharacterization of an LLC as a corporation. This is not considered a proper matter for title insurance as it does not involve a matter of record title and is based on proper compliance with state statutory and federal tax law, as well as a careful analysis of the LLC's constituent documents. It is also considered a matter "created, suffered, assumed or agreed to" by the insured, thus falling within the title policy exclusions.

Title insurers may also resist a request to issue affirmative coverage against a claim of usury in connection with a loan to an LLC. The defense of usury may not be available to an LLC in the same manner as to a general or limited partnership, or a corporation. However, most state LLC statutes provide that an LLC may, by written agreement, be permitted to pay interest in excess of the legal rate (at least up to any statutory criminal rate).

VIII. Citizenship of LLC for Purposes of Diversity Jurisdiction

Since the advent of LLCs, federal courts have struggled with the issue of whether they have subject matter jurisdiction with respect to such entities for federal diversity jurisdiction purposes. In order to invoke federal diversity jurisdiction, the citizenship of the parties must be completely diverse. Although the federal statute establishing diversity jurisdiction, 28 U.S.C. § 1332(c), provides that a corporation shall be deemed to be a citizen of the state in which it is incorporated and has its principal place of business, it is silent with regard to unincorporated entities. The courts must therefore decide whether to make the determination of diversity based on the treatment of an LLC as a corporation, in which event the citizenship of individual members would be irrelevant, or as an unincorporated association, in which event all of the LLC members would have to be citizens of different states to achieve complete diversity.

Relatively few federal cases have dealt specifically with this issue. In *International Flavors and Textures, LLC v. Gardner*, 966 F. Supp. 552 (W.D. Mich. 1997), the plaintiffs, a Michigan limited liability company and one of its two members (a Michigan corporation), sued the other member, a Washington corporation, and its principal, an individual who resided in Washington. The defendants moved, on the basis of diversity jurisdiction, to remove the action to federal court. The court asked the parties to brief the question of whether the court had subject matter jurisdiction. The defendants argued that the Michigan limited liability company was the "equivalent of a corporation" and should be treated as such for diversity-of-citizenship purposes. The plaintiffs argued that the Michigan Limited Liability Act, MCL § 450.4102(2)(1), states that a limited liability company is an "unincorporated association." The court agreed with the plaintiffs, holding that corporations are the only state-created business entities recognized by the Supreme Court as "citizens" for federal diversity purposes, and that the citizenship of an unincorporated association, at least for purposes of diversity jurisdiction, is determined by the citizenship of each of its members. Because the two members of the plaintiff limited liability company were citizens of Michigan and Washington, respectively, the court held that for diversity purposes the limited liability company, as well as one of its members, were citizens of

Washington, as were both of the defendants. Therefore, the court ruled, complete diversity was lacking and the case was improperly removed. The case was remanded to state court.

See also Keith v. Black Diamond Advisors, Inc., 48 F.Supp.2d 326, 330 (S.D.N.Y. 1999) (holding that citizenship for diversity purposes is determined by citizenship of each of LLC's individual members); *U.S.A. Seafood, L.L.C. v. Koo*, 1998 WL 765160, at *1 (S.D.N.Y. Oct. 30, 1998) ("For the purposes of diversity jurisdiction, a limited liability company has the citizenship of its entire membership"); *Chen v. Mayflower Transit, Inc.*, 2001 WL 630688 (N.D. Ill. May 25, 2001) (without allegation as to citizenship of members of LLC, diversity jurisdiction is not adequately established); *JMTR Enterprises, L.L.C. v. Duchin*, 42 F.Supp.2d 87, 93 (D.Mass. 1999) (same); *Cosgrove v. Bartolotta*, 150 F.3d 729, 731 (7th Cir. 1998) (same); *Ferrara Bakery & Café, Inc. v. Colavita Pasta & Olive Oil Corp.*, 1999 WL 135234, at *3 (S.D.N.Y. Mar. 12, 1999) (not reported in F. Supp. 2d) (same); *Conk v. Richards & O'Neil, LLP*, 77 F.Supp. 2d 956 (S.D. Ind. 1999) (holding that citizenship of a limited liability partnership for diversity jurisdiction purposes depends on the citizenship of all its partners); *Cohen v. Kurtzman*, 45 F.Supp.2d 423 (D.C. N.J. 1999) (same); *ALMS, Ltd. v. Barnes*, 1998 WL 907034 (N.D. Tex. Dec. 16, 1998) (same); *ALMS Ltd., LLP v. Guzman*, 1998 W.L. 684245 (N.D. Tex. Sept. 25, 1998) (same); *Mudge Rose Guthrie Alexander & Ferdon v. Pickett*, 11 F.Supp.2d 449 (S.D.N.Y. 1998) (holding that a limited liability partnership continues to exist until winding up is completed and is a citizen of every state of which any of its partners was a citizen when the action was commenced); *Hale v. Mastersoft Int'l Pty., Ltd.*, 93 F. Supp. 2d 1108, 1112 (D. Colo. 2000) ("The Tenth Circuit has not directly determined the citizenship for limited liability companies for purposes of diversity jurisdiction. Other courts, however, have held that a limited liability company is a citizen of the states of which its members are citizens, and is not a citizen of the state in which it was organized unless one of its members is a citizen of that state"); *JMTR Enterprises, L.L.C. v. Duchin*, 42 F. Supp. 87, 93 (D. Mass. 1999) ("A limited liability company is not a citizen of the state in which it was organized, unless one of its members is a citizen of that state" (citing *International Flavors and Textures, supra*)); *JBG/JER Shady Grove, LLC v. Eastman Kodak Co.*, 127 F. Supp. 2d 700, 702 (D. Md. 2001) ("A limited liability company's citizenship, for diversity jurisdiction is determined by all of its members. A limited liability company is not to be treated as a corporation for citizenship purposes); *cf. Carlos v. Adamy*, 1996 WL 210019, at *3 n. 4 (N.D.Ill. April 17, 1996) (concluding, in *dicta*, that a limited liability company is a citizen of the state in which it has its principal place of business). *See also Limited Liability Transactions Share Citizenship of Members*, 12 No. 9 Fed. Litigator 248 (1997).

IX. Standing to Sue Under Operating Agreement

The issue of who has standing to sue under an LLC operating agreement has been the subject of conflicting court decisions. Few LLC enabling statutes have specifically addressed this issue, i.e., does the right to sue belong to the members of the LLC, the LLC itself, or both? The answer may depend on a determination of the party (or parties) to whom the duty of performance is owed and the party (or parties) who were directly injured by the alleged breach. *See* Carter G. Bishop and Daniel S. Kleinberger, *Limited Liability Companies*, Tax and Business Law (Warren, Gorham & Lamont 1994), § 5.06 [6] [b]. No LLC statute contemplates the LLC itself being a party to the operating agreement. However, the LLC could be considered a third-party

beneficiary of the operating agreement, or it could be named as a party to the operating agreement and execute the agreement in its own right, through an authorized member or manager.

In *Bubbles & Bleach, LLC v. Becker Opticians, Inc.*, 1997 U.S. Dist. LEXIS 7471 (N.D. Ill., May 23, 1997), a Wisconsin LLC (based on the authority and consent of one of its members pursuant to Wisconsin's LLC statute) sued the LLC's managing member and a corporation controlled by the managing member, alleging fraud, breach of fiduciary duty, conversion, RICO violations, and constructive trust. The defendants argued that the court lacked proper venue because the LLC had not signed the operating agreements or agreed to be bound by the arbitration provisions contained therein (which provided for the arbitration of all disputes among the "parties"). The court ruled that the arbitration clauses did not apply to the LLC, stating that the LLC was "not a party" to the agreement, i.e., only the individual members had executed the operating agreements and "[n]one of the members signed the agreements in a way that purports to bind [the LLC]." *Id.* at *14. The court further noted that "[t]he parties signed only as members of [the LLC] . . . This is apparent from the fact that [the LLC] is not referenced in any manner on the signature page of either the Operating Agreement or the LLC Agreement." *Id.* at 16, n.12. The court further noted that "[u]nlike some state statutes, the Wisconsin LLC statute does not specifically authorize an LLC to commence a legal action in its own name." *Id.* at * 10-11.

The court in *Bubbles & Bleach* seems to imply that the members could have added the LLC as a party to the operating agreements in order to bind it to the arbitration provisions. If the LLC itself is a signatory to the operating agreement, as the court suggests, does it thereby acquire an independent right to sue for "its" losses, as opposed to those of its members? Should the LLC sign the operating agreement solely for the specified and limited purpose of subjecting itself to certain provisions of the operating agreement (e.g., arbitration of disputes that arise under the agreement)?

In *Elf Atochem North America, Inc. v. Jaffari*, 727 A.D. 286 (Del. 1999), the plaintiff, a member of a Delaware LLC, brought an action individually and derivatively (on behalf of the LLC) seeking a determination whether the LLC, which did not itself execute the LLC operating agreement, was nevertheless bound by the arbitration provisions contained in the agreement, and further seeking a determination whether the arbitration provisions were valid under the DLLC Act. The court, acknowledging that this was a case of first impression, held that the LLC was bound by the operating agreement, including the provisions that required all disputes to be resolved exclusively by arbitration or court proceedings in California. In support of its holding, the court stated that "[t]he [DLLC Act] is a statute designed to permit members maximum flexibility in entering into an agreement to govern their relationship. It is the members who are the real parties in interest. The LLC is simply their joint business vehicle." *Id.* at 293. The court ruled that the DLLC Act expressly allows for a derivative suit, and that an LLC member may bring an action in the name of the LLC to recover a judgment in its favor if the manager or member with the authority to do so refuses to bring the action. The court in this case (unlike the court in *Bubbles & Bleach, supra*) has thus adopted the "flexible" approach, i.e., the agreements of all the members of the LLC should be considered as the agreements of the LLC for the purpose of determining the governance and rights of the LLC.

X. Single Member LLCs

The IRS “check the box” regulations, § 301. 7701-2, -3, have eliminated the four-factor test previously used to determine whether an entity should be considered a partnership or a corporation for tax purposes. The new rules provide that any eligible entity may elect to be classified as either a partnership or an association (i.e., a corporation). However, an eligible entity with only a single member or owner that is not required to be classified as a corporation may only elect to be classified as an association or to have the business entity disregarded as an entity separate from its owner, in which case the entity would be treated for federal tax purposes as if it were a sole proprietorship, branch, or division of the organization’s owner. The regulations permit a single-owner unincorporated business entity to be disregarded as a separate entity from its owner and allow an individual or corporation to obtain the limited-liability advantage of a corporation, along with the single-level “pass through” tax advantage of a partnership, by forming a single-member LLC. Many states have amended their LLC statutes to specifically permit the formation of single-member LLCs. If a domestic LLC with a single individual owner is disregarded as an entity separate from its owner, its individual owner is subject to federal income tax as if the company’s business was operated as a sole proprietorship.

Since 1998, single-member LLCs have become very popular in securitized and structured-financing transactions because of their tax advantages, flexibility and low transaction costs. However, there is a question as to whether a single-member LLC will continue to exist upon the sole member’s bankruptcy, death, or dissolution. There is very little legal precedent or case law on this issue. The governing law must be consulted to see if it allows for the continued existence of the LLC after the sole member’s bankruptcy or dissolution. For example, the DLLC Act (under which many LLCs are formed because of the favorable statutory framework) specifically provides for the LLC’s continued existence under such circumstances, unless otherwise provided in the operating agreement. *See* Del. Code Ann. tit. 6, § 18-801 (a)(4). The DLLC Act also provides that by default an LLC’s existence is perpetual. Del. Code Ann. tit. 6, § 18-801 (a) (1). A single-member LLC, whose only member is the entity or individual in question, requires the creation of only one entity, the LLC itself. *See* Larry E. Ribstein and Robert R. Keating, *Ribstein and Keating on Limited Liability Companies*, Ch. 4, p.3 (1996) (Fall 2001 Update).

The single-member LLC must decide whether to utilize a written operating agreement. Most state LLC statutes provide that in the absence of a written operating agreement, the statutory “default” provisions will apply. For example, the DLLC Act provides that a single-member LLC may have an LLC agreement even with only one member (which agreement need not be in writing), and further provides that an LLC’s operating agreement is not unenforceable solely because there is only one party to the agreement. *See* Del. Code Ann. tit. 6, §18-101(7). Although logically it may seem anomalous to have an agreement with yourself, the existence of a written agreement would be important for creditors of the LLC and other parties who contract with the LLC (for purposes of authorization and the obligation of the sole member to contribute capital), as well as for those who may succeed to the interest of the single member -- who would rely on the terms of the LLC agreement in determining their rights and duties.

The single-member LLC operating agreement should specifically provide for the continued existence of the LLC upon the sole member’s dissolution or the termination of its membership in the LLC. The operating agreement should also condition the sole member’s right to withdraw on

the existence of a succeeding member (sometimes referred to as a “springing” member) who would be capable of continuing the operations and existence of the LLC. Typical “bankruptcy remote” provisions, which are promulgated by rating agencies and appear in almost all LLC formative documents involving securitized loan transactions, would also be applicable with respect to single-member LLCs. Legal opinions as to the bankruptcy remoteness of the borrowing entity (and perhaps its principals) are also usually also required by the rating agencies, such as Moody’s, Fitch, and Standard & Poor’s, in connection with securitized financing transactions to provide support for a high rating. This is especially so in connection with a single-member LLC, where the bankruptcy treatment of such a vehicle is less clear. The enforceability of choice-of-law provisions in LLC documents is also extremely important, because the ability of a single-member LLC to continue in existence after the departure of the sole member is often dependent on state law that enables the single-member LLC to continue in existence.

The efficacy of a single-member LLC as an asset-protection vehicle has been thrown into doubt by a Colorado bankruptcy-court decision. In *In re Ashley Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003), the debtor, who filed a Chapter 13 bankruptcy petition that was later converted to a Chapter 7 liquidation, was the sole member and manager of a Colorado LLC at the time of the filing. The LLC was not a debtor in bankruptcy. The Chapter 7 trustee contended that because the debtor was the sole member and manager at the time the debtor filed bankruptcy, he now controlled the LLC and could therefore sell the real property owned by the LLC and distribute the net sales proceeds to the bankruptcy estate. The debtor argued that the trustee acted only for the debtor’s creditors and at most was entitled to a statutory charging order (against distributions made on account of the debtor’s LLC membership interest) and could not assume management of the LLC or sell its property. The court referred to the Colorado LLC statute, under which the debtor’s membership interest constituted the personal property of the member. According to the court, “[b]ecause there are no other members in the LLC, the entire membership interest passed to the bankruptcy estate, and the trustee became a ‘substituted member.’” *Id.* at 540. The court also stated that, “upon the Debtor’s bankruptcy filing, the Trustee now controls, directly or indirectly, all governance of that entity, including decisions regarding liquidation of the entity’s assets.” *Id.* at 541. The court reasoned that because there were no other members in the LLC, no written unanimous approval of the transfer was necessary, as would be the case under Colorado law if there were other members – no matter how small such other membership interests may be.

(Colorado’s LLC statute, similar to those in other states, provides that if such unanimous consent is not obtained, the bankruptcy estate is only entitled to receive the bankrupt member’s share of the profits or other compensation that the bankrupt member was otherwise entitled to and would not be entitled to any role in the voting or governance of the LLC. However, in a footnote the court stated that this statutory limitation “does not create an asset shelter for clever debtors. To the extent a debtor intends to hinder, delay or defraud creditors through a multi-member LLC with ‘peppercorn’ co-members, bankruptcy avoidance provisions and fraudulent transfer law would provide creditors or a bankruptcy trustee with recourse.” *Id.* at 541 n.9). The court rejected the debtor’s assertion that the trustee should be entitled only to a charging order, holding that a charging order existed only to protect other members of an LLC, and in a single-member LLC there were no non-debtor members to protect. The court ruled that the trustee, as the sole member of the LLC, controlled the LLC and could cause the LLC to sell its property and

distribute the net proceeds to the bankruptcy estate, or alternatively the trustee could elect to distribute the LLC's property to the bankruptcy estate, and then liquidate the property himself. However, the court did permit the debtor to make a claim for her post-petition mortgage payments to preserve the real property of the LLC, which was now an asset of the bankruptcy estate.

But see Puleo v. Topel, 368 Ill. App.3d 63 (2006), involving liability arising out of the contractual activity of an LLC. In this case (acknowledged by the court to be an issue of first impression under the Revised Act), the court held that the member-manager of an LLC was not personally liable for unpaid debts to independent contractors engaged to perform work after the LLC was involuntarily dissolved for failure to file its 2001 annual report. The court reasoned that because in 1998 the legislature removed the provision in Section 10-10 of the Illinois Limited Liability Act that allowed a member or manager of an LLC to be held personally liable in the same manner as provided in 805 ILCS 5/3.20 (i.e., for his or her own actions or for the actions of the LLC to same extent as a director or shareholder of a corporation), the current Revised Act did not provide for a member or manager's personal liability to a third party for an LLC's debts. The court held that under § 10-10 of the Revised Act a member or manager could only be held personally liable for debts and obligations of the LLC if “(1) a provision to that effect is contained in the articles of organization; and (2) a member so liable has consented in writing to the adoption of the provision or to be bound by the provision (citation omitted).” The court found that in this case neither of these specific requirements had been alleged or proven by the plaintiffs and therefore, “under the express language of the [Illinois Limited Liability Company] Act, plaintiffs cannot establish [the LLC member-manager's] personal liability for debts that [the LLC] incurred after its dissolution.” *Id.* at 68. As this case demonstrates, an LLC may be a better shield from liability to the members and managers of the entity than a corporation. However, this was an action brought upon an alleged breach of contract, and it is unsure whether a court would apply the same principles (and holding) if the case had arisen out of a tort claim instead of a contractual dispute. *See also Wachovia Securities, LLC v. Neuhauser*, 2007 WL 4246894 (N.D. Ill., Nov. 29, 2007), at *15 (referring to Illinois Appellate Court's ruling in *Puleo, supra*, court rejected plaintiff's argument that because LLC was dissolved at the time sole member-manager opened trading account, member-manager could be held personally liable for LLC's alleged breach of contract as a "member or manager" to same extent as a director or shareholder under Section 10-10 of the Illinois Limited Liability Act and Section 5/3.2 of the Illinois Business Corporation Act; court held that 1998 revision to § 10-10 of Illinois Limited Liability Act did not provide for a member or manager's personal liability to third party for an LLC's debts; accordingly, sole member-manager of LLC could not be held liable for LLC's debts even though LLC was dissolved at the time single member-manager opened the account); Lin Hanson, *LLCs and Asset Protection*, 95 ILL. B.J. 662 (2007) (discussing *Albright* and *Puleo* decisions); Christopher M. Riser, *Asset Protection Basics: Using Partnerships and LLCs*, 24 THE PRACTICAL REAL ESTATE LAWYER 27 (2007) (discussing various ways LLCs can serve as practical and effective asset-protection devices).

The DLLC Act specifically provides for the exercise of a deceased or terminated member's rights by a personal representative. Del. Code Ann. tit. 6, § 18-705. The DLLC Act also provides for termination of an LLC without members, but contains a mechanism to prevent the winding up the LLC. The DLLC Act permits the admission of a personal representative of the departed member within 90 days after such departure, if the representative agrees in writing to be

admitted or such representative is admitted pursuant to a provision in the LLC agreement providing for such admission on the departure of a member. *See* Del. Code Ann. tit. 6, § 18-801(a)(4). With respect to Illinois LLCs, § 180/35-1(3) of the Revised Act provides that dissolution occurs if an event occurs (such as the absence of members) that makes it unlawful to continue the business, but permits the continuation of the LLC if within 90 days after the LLC has notice of such event, the illegality is cured. (It is uncertain how the LLC would acquire “notice” of the act when its only member is an individual who has died).

It has been suggested that the single-member LLC operating agreement provide (where permitted) that a board of managers, containing at least two “independent” members, would govern certain management and operating decisions. The operating agreement would provide that no bankruptcy filing or related action could occur without the unanimous consent of all the board members. *See* Alexander Dill, Yaron Ernst, Michael Kanef, and Adam Toft, *Handle With Care: Single Member LLCs in Structured Transactions*, Special Report, Moody’s Investor Services, March 19, 1999. However, if the outside managers are not truly independent and do not perform their fiduciary duty to the entity (and to all creditors, including unsecured creditors), as opposed to specific third-party creditors, the goal of bankruptcy-remoteness may not be achieved.

Another proposed method of enhancing the bankruptcy-remoteness of a single-member LLC is to structure the entity so that the sole member is itself a single-purpose bankruptcy-remote entity. Unlike an individual, who can (and eventually will) die, the sole member of a single-member LLC that is itself structured as a single-asset bankruptcy-remote entity will have a perpetual existence. However, borrowers may resist the imposition of such a requirement because they lose some of the flexibility and cost-saving advantages, including direct personal ownership, of single-member LLCs.

A sample short-form Illinois single-member LLC Operating Agreement is attached hereto as **Appendix O**. This form provides for the possibility that the single-member LLC may eventually evolve into an LLC with two or more members. This form also addresses some corporate-governance and other matters in the (unlikely) event that a member voluntarily or involuntarily disassociates from the LLC.

XI. Limited Liability Partnerships

In 1991, Texas became the first state to allow professional firms to organize as limited liability partnerships (“LLPs”). Almost all other states have since enacted statutes that permit LLPs, which are a form of general partnership except that each general partner may not be liable for certain liabilities of other partners and/or the partnership. (A notable exception had been Illinois, where law firms -- but not other professional organizations -- until recently were prevented by Illinois Supreme Court Rule 721 from organizing as LLPs). However, Chicago law firms have won the right to convert to LLPs following a decision by the Illinois Supreme Court to end the state ban. Effective July 1, 2003, the state implemented new definitions to Supreme Court Rules 721 and 722, which restricted partnerships from converting to LLPs. The move, which allows partners to protect personal assets in the event of claims against the law

firm, was obviously welcomed by the major Illinois law firms. The decision followed lobbying from the Chicago Bar Association and the Illinois State Bar Association, including a joint petition submitted to the court requesting an end to the ban in Illinois, the only US state not to allow partnerships to adopt the structure. Pressure for reform intensified following the large number of corporate collapses in 2002, which led to fears that lawyers and their firms would be targeted in shareholder litigation. Notably, Kirkland & Ellis was last year included with major Texas law firm Vinson & Elkins (and nine banks) in a multi-billion claim asserted by former shareholders of Enron -- the largest claim ever filed against a law firm. New York legal behemoth Cravath Swaine & Moore announced that it was converting to an LLP, while other major competitors, including Simpson Thacher & Bartlett and Davis Polk & Wardwell, are also considering converting to LLPs.

Under these LLP statutes, only those partners responsible for negligence or mistakes would potentially expose their personal assets to risk of liability, and the liability of the other partners would be limited to the amount of their capital contributions to the firm and the amount of their personal loan guarantees to the firm (if any). It is estimated that as many as 60 percent to 70 percent of all law firms and other are now organized as LLPs instead of ordinary partnerships. See Martha Neil, *Partners at Risk*, ABA Journal (August, 2002), p. 44. Most LLP statutes carve out one specific type of partnership liability from the usual general liability of general partners – usually vicarious tort liability due to the errors, incompetence, negligence, fraud, wrongful acts, omissions, malpractice, or misconduct of a co-partner, employee, or agent, when not supervised by or under the direct control of the protected partners. See, e.g., MCLA sec. 449.44-48 (1994); *Commentary*, New Illinois Supreme Court Rules 721 and 722 (April 1, 2003) (“Rule 721 imposes joint and several liability on lawyers with an ownership interest in law firms organized under statutes that purport to limit vicarious liability, for claims arising out of the performance of professional services by any firm lawyers or employees, unless the firm maintains minimum insurance or proof of financial responsibility in accordance with Rule 722. For lawyers with an ownership interest in such firms to obtain the limited liability authorized by statute, Rule 722 imposes additional obligations, beyond any statutory requirements, to provide sufficient professional liability insurance or other funds to protect clients with such claims. Rules 721 and 722 do not reduce lawyers' liability for their own professional conduct or that of persons under their direct supervision and control. Nor do these rules affect lawyers' ethical responsibilities for their own conduct, or that of their law firm or their firm's lawyers or employees, under Rules 5.1, 5.2, or 5.3 of the Rules of Professional Conduct”).

Under an LLP statute, the general partners remain liable for all tax obligations of the partnership and all liabilities and debts of the partnership arising from their own wrongful acts, the wrongful acts of one under their direct supervision and control, and from activity not involving negligence, wrongful acts, omissions, misconduct, or malpractice. Presumably, the limitations on liability set forth above would not extend to breach of contracts or defaults on notes or other partnership obligations (such as indebtedness for borrowed money, contract claims and regular commercial debts and obligations) unless such breaches or defaults were fraudulent or otherwise wrongful. LLPs are often the best choice of entity for law firms, accounting firms, and other businesses offering professional services, whose main exposure to liability is due to the principals' wrongful conduct. On the other hand, the LLC form of entity may be more attractive for businesses with large contractual liabilities or significant loan obligations. See John

Richards, *Note: Illinois Professional Service Firms and the Limited Liability Partnership: Extending the Privilege to Illinois Law Firms*, 8 DePaul L. Rev. 281 (1996).

While most state LLP legislation limits LLPs to professionals, some states have broadened the coverage to other types of businesses. For example, Michigan amended its LLP statute to create a limited liability limited partnership (“LLLP”). The amendment permits filings by limited partnerships under the provisions of the LLP statute. General partners in LLPs are protected from losses arising from the activities of other general partners in the same way that LLP partners are protected under the existing LLP statute. *See* M.C.L.A. sec. 449.1101 *et seq.*; M.C.L.A. sec 449.1403(b). In Texas, a limited partnership can also be an LLP, which provides additional protection when there are several general partners. *See* Michael Indenbaum and Jeff Adelman, *Limited Liability Partnerships: Another Choice of Entity for Michigan Businesses*, Michigan Bar Journal, September 1995, p. 946; Robert R. Keatinge, George W. Coleman, Allan G. Donn and Elizabeth G. Hesler, *Limited Liability Partnerships: The Next Step in the Evolution of the Unincorporated Business Organization*, 51 Bus. Law 197 (November 1995).

New York’s Limited Liability Company Law and Limited Liability Partnership Provisions, which were amended in 1994, specifically extend the protections provided therein to contractual causes of action as well as tort actions. In most states, the effect of LLP legislation is to shield the assets of individual partners – but not the entity – from tort judgments based on professional liability against the entity or one of the members. A typical LLP, such as a law firm, should be careful to maintain customary malpractice insurance coverage and limits to cover the torts for which liability under the applicable LLP statute is shielded, because the LLP’s status does not affect the entity’s liability for the torts of partners and employees or the availability of its assets to pay a judgment against it, or the necessity for each member to protect personal assets in the event of his or her own personal negligence or other torts. In any event, a law firm’s insurance carrier should be advised in advance when the firm is considering converting to an LLP form of organization. *See* Kirsten L. Christophe, *Continuing Protection – Converting to a Limited Liability Structure Raises Key Insurance Issues*, ABA Journal, September 1995, p. 92.

LLPs are governed by well-established partnership law in all states (as well as the partnership provisions of the Bankruptcy Code), whereas LLCs are subject to evolving state law (and uncertain treatment under the Bankruptcy Code) and may be treated differently on a state-by-state basis. The LLP form of entity may, therefore, provide more flexibility and certainty of treatment in interstate and multistate transactions. Members of an LLP are known simply by the familiar term of “partners,” rather than members or managers. There is no limit to the number of partners in an LLP, and an LLP may have one or more subsidiaries. In addition, the administrative burden of an LLP is minimal because there is no requirement for annual meetings or elections and usually only brief, periodic reports need to be filed with the Secretary of State or other state official.

The Bankruptcy Reform Act of 1994 specifically amended sec. 723(a) of the Bankruptcy Code to take into account the existence of the limited liability protections of LLPs by providing that the liability of individual general partners for the amount of any deficiency in the amounts due creditors after the distribution or liquidation of partnership assets would only exist “to the extent that under nonbankruptcy law such general partner is personally liable for such deficiency.” (However, most LLP statutes only shield partners from tort liability for the acts of

others not under their direct control). The protections available to individual LLP partners are of greatest importance when a professional firm files (or has filed against it) a bankruptcy proceeding. According to one commentator, “Some bankruptcy courts have devised another way to protect partners when firms don’t or can’t organize LLPs. They use creditor releases and injunctive relief to prevent future creditor claims against partners who have settled their share of the firm’s debt.” See Neil, *Partners at Risk*, *supra*, at p. 47. Because relatively few professional-firm dissolutions result in bankruptcy filings, there have been very few court cases that have considered the validity and enforceability of such releases and injunctions.

The legal validity of the LLP structure has as yet not been seriously challenged, and there is little case law in this area. However, the recent collapse of Enron, WorldCom, Adelphia and other high-profile public companies, and the related claims asserted against the accounting and law firms that represented these entities, could change the landscape and result in court tests of certain limited-liability features of an LLP.

In most states, the conversion of an existing partnership or a limited liability company can be done quickly and inexpensively by filing a notice with the Secretary of State or other state official; there is no need to form a new entity and transfer partnership assets to the new entity. Also, an LLP (as well as a properly structured LLC) qualifies for full discount for valuation purposes under federal estate and gift tax rules and regulations. Therefore, an interest in a family-owned LLP can be transferred to children and grandchildren under the annual gift tax exclusion and at a significant discount for estate and gift tax purposes. As a result of this favorable tax treatment, an LLP may become the ownership vehicle of choice for many family-owned businesses, such as agricultural operations.

XII. Bankruptcy Issues

Because LLCs are still relatively new state-law creations, the treatment of these entities in bankruptcy is uncertain, i.e., will they be treated as partnerships or corporations for bankruptcy purposes? See *In re ICLNDS Notes Acquisition, LLC*, 259 B.R. 289, 292 (Bankr. N.D. Ohio 2001) (“an LLC is neither a corporation or a partnership, as those terms are commonly understood. Instead, an LLC is a hybrid”); *In re Avalon Hotel Ptnrs., LLC*, 302 B.R. 377, 380 (Bankr. D. Or. 2003) (“LLCs are hybrid business entities, with attributes of both corporations and partnerships”); *In re Allentown Ambassadors, Inc.*, 361 B.R. 422, 442 (Bankr. E.D. Pa., 2007) (same). See also Carter G. Bishop, *Treatment of Members upon Their Death and Withdrawal from a Limited Liability Company: the Case for a Uniform Paradigm*, 25 STETSON L. REV. 255, 258 (1995) (stating that an LLC “combines the two most critical features of all of the other business organizations in a single business organization—a corporate-styled liability shield and the pass-through tax benefits of a partnership”).

This uncertainty is especially troublesome with respect to single-member LLCs. This is so because if an LLC is treated as a partnership, it could dissolve upon the bankruptcy of its sole member and its assets distributed to creditors and the bankrupt member. If, on the other hand, the

LLC were treated as a corporation, it would not dissolve upon the bankruptcy of the last remaining member, although the member's ownership interest could be transferred. Some commentators believe that, at least under the DLLC Act, an LLC should be treated as a corporation because the LLC operating agreement is similar to a certificate of incorporation and a member's interest is analogous to a share of stock in a corporation. *See* Larry E. Ribstein and Robert R. Keatings, *Limited Liability Companies*, § 14.04, at 14-18 (2000) (“[F]rom a policy standpoint, LLCs probably should be considered corporations for bankruptcy purposes because the special bankruptcy provisions that apply to partnerships primarily relate to the general partner's duty to contribute to payment of the firm's debts”); Carter G. Bishop and Daniel S. Kleinberger, *Limited Liability Companies Tax and Business Law*, ¶1.04 (2)(a) (1999).

Bankruptcy courts generally look to state law to determine whether dissolution occurs upon the bankruptcy of the sole member. Under the DLLC Act, for example, an LLC whose member is in bankruptcy would be treated as if it were a corporation with a bankrupt shareholder and the bankruptcy would not cause a dissolution. If a Delaware LLC agreement is properly drafted, under Delaware law even the bankruptcy of the last remaining member will not, by itself, cause the dissolution of the LLC. Furthermore, under the DLLC Act, it is permissible to admit “springing members,” i.e., a person may be admitted as a member (including as the sole member) without acquiring an interest in the LLC or being required to make a capital contribution. *See* Del. Code Ann. tit. 6, §§ 18-801(a)(4) and (b); James G. Leyden Jr., *A Key State's Approach to LLCs: Delaware Can Be Different*, 9-MAY Bus. L. Today 51, 63 (2000).

There are no specific provisions in the Bankruptcy Code (“Code”) or Bankruptcy Rules that deal with LLCs, and the application of bankruptcy law and specific Code provisions is uncertain. The Code does not include an LLC within the definition of a debtor that is eligible for relief. However, it is likely that a bankruptcy court would conclude that an LLC would qualify as a debtor under the Code. *See In re ICLNDS Notes Acquisition, LLC, supra*, 259 B.R. at 292 (“There is no specific reference in the Code to a limited liability company. Under the rules of construction applicable to the Code, however, the use of the term “includes” is not limiting In other words, individuals, corporations and partnerships are clearly eligible for relief, but other similar entities are as well”); Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, *Limited Liability Companies in Bankruptcy*, in *The Best Entity for Doing the Deal*, at 747, 763-64 (PLI Corp. Law and Practice Course Handbook Series No. 747 (1996)). Case law is just beginning to develop in this area. Does an LLC qualify as a “corporation” (which includes an “association having a power or privilege that a private corporation, but not an individual or a partnership, possesses” and a “partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association”) as defined in sec. 101(9) of the Code, or does it qualify as a “person” (which includes an “individual, partnership and corporation”) as defined in sec. 101(41) of the Code? As noted above, the Code currently does not recognize an LLC as a distinct or separately defined entity. However, a court may find that an LLC has significant similarities to both partnership and corporate entities to qualify as a “person” entitled to protection under the Code. *See In re ICLNDS Notes Acquisition, LLC, supra*, 259 B.R. at 293 (“[a]s corporations and partnerships are eligible to be debtors, and because an LLC draws its character from both of those forms of doing business, an LLC is similar enough to those entities that it also comes within the definition of “person” and is eligible for protection under the Code”); *In re Midpoint Development LLC*, 313 B.R. 486, 488-89 (Bankr. W.D. Okla. 2004) (holding that LLCs are

sufficiently analogous to corporations and partnerships to be debtors under the Code, and stating that under Oklahoma LLC Act, “a dissolved limited liability company qualifies as a debtor in order to wind up its affairs”).

Where and whether an LLC files a bankruptcy petition can be different depending on whether corporate or partnership characteristics are deemed to apply. Proper authorization for the filing of a voluntary bankruptcy petition will depend on whether the LLC is treated as a partnership or a corporation, and such determination may be different depending on whether the LLC is member-managed or manager-managed. If the LLC is member-managed and is treated as a partnership under the Code, all of the members would be required to consent to a bankruptcy filing. If the LLC is managed by one or more designated managers, it is unclear (absent specific provisions in the LLC’s operating agreement) whether the manager(s) alone may determine whether to file a bankruptcy proceeding, or whether the filing of a bankruptcy petition is such an extraordinary event that all members would be required to consent. An LLC’s operating agreement should expressly address who is authorized to file a bankruptcy petition on behalf of the LLC. See *In re Avalon Hotel Ptnrs., LLC*, *supra*, 302 B.R. at 381 (ruling that the filing of bankruptcy petition by LLC’s manager without member approval was not authorized under either State law or operating agreement, but consent resolution was effective to ratify petition and render bankruptcy filing properly authorized where operating agreement provided for amendment of operating agreement by written consent of 75% of members); Federal Rule of Bankruptcy Procedure 1004 (which requires the consent of all partners to the filing of a voluntary petition on behalf of a partnership and requires service of an involuntary petition on all non-petitioning general partners); Thomas F. Blakemore, *Limited Liability Companies and the Bankruptcy Code*, 13 Am. Bankr. Inst. J. 12 (June 1994).

It is also unclear whether an LLC could contest the filing of an involuntary Chapter 7 or Chapter 11 bankruptcy petition against it on the basis that it is not a “person” under sec. 101(41) of the Code, or whether an LLC could convert a Chapter 11 proceeding to a Chapter 7 proceeding. Section 303(a) of the Code states that an involuntary bankruptcy proceeding may be filed only against “a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such case is commenced.” Under sec. 303(d) of the Code, a general partner in a partnership debtor that did not join in the filing of an involuntary bankruptcy petition may challenge the petition and seek to have it denied. This provision would apply to an LLC only if it is treated the same as a partnership in bankruptcy. If an LLC is treated as a corporation in bankruptcy, only creditors would be permitted to file an involuntary petition against the LLC, and individual members could not file an involuntary proceeding against the LLC. (The operating agreement could even expressly prohibit such a filing.)

Under most state LLC statutes, if a member files a bankruptcy case the LLC automatically dissolves (unless otherwise specified in the operating agreement). Is this provision of a state LLC statute overridden by the Code because it constitutes an *ipso facto* clause (i.e., a clause that modifies or eliminates a party’s contractual rights solely because of a bankruptcy filing) which is unenforceable under sections 541(c)(1), 363(l) and 365(e) of the Code? The answer may depend on whether the articles of organization and operating agreement are regarded as executory contracts (i.e., contracts on which performance remains due to some extent on both sides). The question then becomes whether these documents are “organic” governing documents (as opposed

to executory contracts) and whether a bankruptcy court, even if it held the documents to be executory, would enforce the documents with the sole exception of the bankruptcy-remote provisions if the agreements were rejected, or permit such rejection to cause a dissolution of the LLC without providing at least a “winding down” period.

If the LLC cannot be dissolved because of the bankruptcy, will this have an adverse impact on characterization of the entity for tax purposes because it will then have continuity of life? Will such a determination depend on whether a member of an LLC files a Chapter 7 proceeding or a Chapter 11 proceeding? Can the bankrupt member assign some or all of his, her or its LLC interest, despite statutory or contractual provisions that prevent such a transfer? If the bankrupt member is also a manager, is the distraction of the bankruptcy and the lack of an on-going financial interest in the entity likely to affect his or her actions on behalf of the LLC? Under recently enacted amendments to the Illinois LLC act, a member who becomes a debtor in bankruptcy, executes an assignment for the benefit of creditors, etc., becomes a “dissociating member” and such a member’s right to participate in the management of the LLC thereupon terminates. See James M. Jorissen, *Member Bankruptcy Under the New Minnesota Limited Liability Company Act: An Executory Contract Analysis*, 77 MINN. L. REV. 953 (1993).

In *In Re Daugherty Construction, Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995), the court held that the LLC articles of organization and operating agreements of the two LLCs of which the debtor was a member were executory contracts that the debtor could assume or reject. The court also found that the state LLC statute providing for dissolution of an LLC upon a bankruptcy filing by a member violates the Code, and therefore was not enforceable against the debtor-member upon commencement of the debtor-member’s bankruptcy case. The court further held that the actions of the other members of the two LLCs upon commencement of the debtor-member’s Chapter 11 bankruptcy petition, including holding meetings in the debtor’s absence, voting to continue the LLCs’ construction business, and actually continuing and controlling the LLCs’ business under new membership, violated the automatic stay provisions of sec. 362(a) of the Code and would be set aside to the extent that they impaired, modified, or terminated the member-debtor’s interest in the limited liability companies. However, because this was a case of first impression and the court determined that the acts of the other members appeared to be good faith attempts to protect their interests in the LLCs under the operating agreement and the state LLC statute, the court concluded that sanctions against the other members were not appropriate.

See also *In the Matter of GP Express Airlines, Inc.*, 200 B.R. 222, 232 (Bankr. D. Neb. 1996) (the court, citing *In re Daugherty*, stated that “the Bankruptcy Code will not enforce provisions in private agreements or under nonbankruptcy law which terminate a debtor’s interest in property or an executory contract merely because of a bankruptcy filing”); *In re Sandman Associates, L.L.C.*, 251 B.R. 473, 482-43 (W.D.Va. 2000) (holding that where debtor LLC filed Chapter 11 bankruptcy petition solely for purpose of rejecting alleged executory contract to admit new member, new member’s failure to execute LLC operating agreement as provided in contract was not material breach that would create executory contract that debtor could reject). Cf. *Movitz v. Fiesta Investments, LLC (In re Ehmman)*, 319 B.R. 200, 205-06 (Bankr. D. Ariz. 2005) (holding that LLC operating agreement was nonexecutory contract where no material obligations were imposed on members, raising possibility that bankruptcy trustee could force liquidation of member’s interest notwithstanding limitations in operating agreement); *Tsiaoushis v. Endeke Enterprises, Inc., L.L.C. (In re Tsiaoushis)*, 383 B.R. 616, 619 (Bankr. E.D. Va. 2007)

(holding that although there is no *per se* rule and each operating agreement must be separately analyzed, the LLC's operating agreement in this case was not an executory contract and provision in agreement for automatic dissolution upon filing of bankruptcy by member who had ceased to be managing member pre-petition was not an unenforceable *ipso facto* clause under § 365(e) of the Code; the court stated that "[t]he failure to perform a remote and speculative fiduciary duty [to vote for future additional capital contributions], if one exists, is not a 'material breach excusing the performance of the other'" (internal quotations and citation omitted)); *In re Capital Acquisitions & Management Corp.*, 341 B.R. 632, 636-37 (Bankr. N.D. Ill. 2006) (concluding that, after reviewing the specific operating agreement at issue in this case, operating agreement was not an executory contract. *See generally* Anthony Michael Sabino, *Litigating the Limited Liability Company, Part II: A Tale of Two Bankruptcy Courts*, 69-APR N.Y. St. B.J. 22 (1997); *Limited Liability Companies and Bankruptcy*, Report by the Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, 937 PLI/Corp. 747, 800-05 (1996).

But see In re Allentown Ambassadors, Inc., *supra*, 361 B.R. at 444 ("Here, I conclude that the Operating Agreement is an executory contract. I find that the members of the . . . LLC had ongoing, material, unperformed obligations to one another and the LLC as of the commencement of this bankruptcy case"). *See also* T. Randall Wright and Joyce A. Dixon, *Bankruptcy Issues in Partnership and Limited Liability Company Cases*, SN083 ALI-ABA 457 468 (2008):

In general, the courts will look to the substance of the partnership agreement or operating agreement to determine if there are unperformed obligations by the parties. If so, they usually find that it is an executory contract and therefore subject to assumption or rejection. For those courts that find that such agreements are executory contracts, the perplexing issue of whether and under what circumstances the general partner or managing member should be permitted to assume and/or assign these agreements has brought differing results. This may be a critical issue in the case, such as in those instances where the general partner or manager draws its primary revenues from the partnership, or where the other general or limited partners or members are unhappy with the bankrupt general partner.

In *Broyhill v. DeLuca (In Re DeLuca)*, 194 B.R. 65 (Bankr. E.D. Va. 1996), the court held that an operating agreement is an executory contract, but that because the object of the agreement (the development of a real estate project) had been started but not yet completed and the parties had on-going duties and responsibilities with respect to the successful conclusion of the project, the nature of those duties and responsibilities constituted a contract for personal services under applicable state law because the identity of the managers was material to the existence of the LLC. The court noted that such a contract for personal services cannot be forced on an unwilling party and is not subject to the Code prohibition on the enforceability of *ipso facto* clauses. The court further noted that "for the purpose of analyzing the effect of a member's bankruptcy upon the continued exercise of membership rights, it seems most appropriate to treat the relationship among members of a limited liability company as analogous to that of that [sic] among the partners of a partnership." *Id.* at 74. The court also stated that an LLC "is a form of

legal entity that has attributes of both a corporation and a partnership but is not formally characterized as either one. Generally, an LLC offers all of its members, including any member-manager, limited liability as if they were shareholders of a corporation but treats the entity and its members as a partnership for tax purposes.” *Id.* at 71. (The court in *In re ICLNDS Notes Acquisition, LLC, supra*, cited this passage from *DeLuca* in support of its holding that an LLC was eligible to file a bankruptcy petition).

In a companion case, *JTB Enterprises, L.C. v. D & B Venture, L.C. (In Re DeLuca)*, 194 B.R. 79 (Bankr. E.D. Va. 1996), the court concluded that because the LLC operating agreement provided that each of the members had an equal vote, the holder of a 50 per cent membership interest could not cast “a majority vote of the members,” as required by the operating agreement, to remove the managing member notwithstanding that the holder of the 50 per cent interest may have had the larger capital account, and the court held that the decision of the member holding such 50% interest to file a Chapter 11 petition on behalf of the LLC was a “major decision” under the operating agreement that required the vote of all the members. The court noted that it was aware that its holdings in the two related *DeLuca* decisions were contrary to the ruling of the court in *In Re Daugherty*, *supra*, but that it believed its holdings were consistent with the controlling authority in the district.

In *In re Garrison-Ashburn, L.L.C.*, 253 B.R. 700 (Bankr. E.D.Va. 2000), the court held that both before and after the enactment of amendments to the applicable LLC statute providing for the continued existence of an LLC, the bankruptcy of a member effected an assignment of that member’s interest, whereby the disassociated member would retain his or her right to share in the LLC profits, losses and distributions but would forfeit any right to participate in management of the LLC. The court also ruled that the operating agreement was not an executory contract because it “merely provides the structure for the management of the company” and “imposes no additional duties or responsibilities on the parties” and the economic interest of the bankrupt member was not impaired nor did it affect the ability of the LLC to continue in business. *Id.* at 708. The court distinguished *In re DeLuca, supra*, by finding that, as opposed to *DeLuca*, “[t]his case does not concern an entity whose organic documents or enabling statute dissolves the entity on the filing of a member’s petition in bankruptcy.” *Id.*

See also *Dye v. Sandman Associates (In re Sandman Associates, L.L.C.)*, 251 B.R. 473, 482-83 (W.D. Va. 2000) (holding that, as a matter of law, an LLC’s letter agreement that it would grant a membership interest to a new member in exchange for a capital contribution was not an executory contract that could be rejected by the LLC, even where the new member had not actually executed the LLC operating agreement); *Solomon v. Barman (In re Barman)* 237 B.R. 342, 348-49 (Bankr. E.D. Mich. 1999) (ruling that an LLC is sufficiently analogous to a corporation for purposes of determining whether one of three members of an LLC was an “insider” under the Code; the court found an insider relationship because member owned or controlled one-third of the voting rights in the LLC and his relationship with the LLC was analogous to that of a corporate director, officer, or person in control; the court stated that his relationship to the other members “could not be said to be at arms length and would require close scrutiny”).

As a result of their negative experiences in recent years involving bankruptcy filings by and against borrowers, real estate lenders have learned that if a borrowing entity with very few

creditors is created, such as a bankruptcy-remote LLC, it will be much more difficult for the borrower to file, or have filed against it, a bankruptcy proceeding or avoid early dismissal. *See, e.g., Barakat v. Life Ins. Co. of Virginia*, 99 F.3d 1520, 1526 (9th Cir. 1996) (holding that where the only bona fide, impaired claim in the bankruptcy case was the claim of the mortgage lender, the debtor “should [not] be able to cramdown a plan that disadvantages the largest creditor”); John C. Murray, *The Lender’s Guide to Single-Asset Real Estate Bankruptcies*, 31 Real Prop. Prob. & Tr. J. 393, 461-471 (Fall 1996); James R. Stillman, *Real Estate Mezzanine Financing in Bankruptcy*, Finance Topics, American College of Real Estate Lawyers, Midyear Meeting, Scottsdale, Arizona, April 4-5, 1997, Tab 24, at 3; Varallo and Finkelstein, *Fiduciary Obligations of Directors of the Financially Troubled Company*, 48 Bus. Law. 239 (1992).

A desirable alternative for a lender seeking to protect its interests without opening itself up to unwanted liability may be to require the LLC to appoint an “independent director,” i.e., a reputable individual or entity with no prior or current affiliation or relationship with either the lender or the LLC, as an additional member of the LLC. However, the inclusion of such a “bankruptcy remote provision” in an LLC operating agreement, especially one that requires approval of certain entity actions by an independent director who is in actuality under the influence of a major secured lender, may later be determined by a bankruptcy court to run afoul of the Code’s prohibition of provisions preventing an entity from commencing a bankruptcy reorganization. Also, several courts have held that as an entity approaches insolvency, i.e., becomes unable to pay its debts as they become due in the ordinary course of business, the directors owe a fiduciary duty to all the creditors of the company. In *In re Kingston Square Associates*, 214 B.R. 713 (Bankr. S.D.N.Y. 1997), the debtor was unable to obtain its board of directors’ permission to file a voluntary bankruptcy proceeding because of the refusal of the “independent director” to authorize such a filing. The debtor then orchestrated an involuntary filing by certain unsecured creditors (with the help of the debtor’s limited partners). The bankruptcy court found that such actions were not taken in bad faith and that the debtor reasonably believed that the best course of action for the entity was to file bankruptcy. The court further held that such actions were necessary because the “independent director” had abdicated his fiduciary duty to the debtors, creditors and limited partners in favor of the interests of the mortgage lender. The court therefore refused to grant the secured creditor’s motion to dismiss the involuntary filing. The court also appointed a Chapter 11 trustee, and held that the debtor’s board of directors had violated their fiduciary duties owed to the debtor, its limited partners and its unsecured creditors and interest holders, in favor of the interests of the mortgage lender. The court declined, however, to specifically nullify the debtor corporation’s bylaw provision containing the bankruptcy-proof provisions as against public policy. In *In re Avalon Hotel Ptnrs, LLC, supra*, the Oregon bankruptcy court held that the equitable doctrine of “judicial estoppel” (which precludes a party from taking inconsistent positions in different courts) did not apply to a promise made by the LLC to a state court and its manager not to file a Chapter 11 bankruptcy petition. The court stated that, “[a]s a matter of public policy, it is not appropriate to enforce judicial estoppel where the impact would fall not just on the alleged offending parties [the LLC and its manager], but also on parties to which a chapter 11 debtor in possession owes fiduciary duties, including minority member who are not parties to the State Court litigation . . . and creditors in this case”. *Id.* at 383. The court also ruled that the LCC’s filing of a Chapter 11 bankruptcy petition was done in good faith, because it involved more than a simple two-party dispute and was necessary to maximize the value of the LLC’s assets for all the LLC’s creditors.

See also *In re Cumberland Farms, Inc.*, 249 B.R. 341, 349-51 (Bankr. D. Mass. 2000) (finding clear breach of duty where director caused cash flow from property to be used to repay loans from “his” company to detriment of debtor’s finances generally, and noting that directors must act “with absolute fidelity and must place their duties to the corporation above every other financial or business obligation . . . They cannot be permitted to serve two masters whose interests are antagonistic”); *Geyer v. Ingersoll Pub. Co.*, 621 A.2d 784, 787-89 (1992); *Credit Lyonnais Bank, Nederland, N.V. v. Pathe Comm. Corp.*, No. 12150, 1991 WL 277613 (Del. Ch., Dec 30, 1991); *In re Andreuccetti*, 975 F. 2d 413, 421 (7th Cir. 1992); *Clarkson Co., Ltd. v. Shaheen*, 660 F.2d 506, 512 (2nd Cir. 1981); *Tampa Waterworks Co. v. Wood*, 121 So. 789 (Fla. 1929); *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981); *In re Schulz*, 208 B.R. 723, 729 (M.D. Fla. 1997); *Equity-Linked Investors, L.P. v. Adams*, 705 A.2d 1040, 1042 n.2. (Del. Ch. 1997); *In re Brian Jacks*, 243 B.R. 385, 390 (Bankr. C.D. Cal. 1999); *Credit Agricole Indosuez v. Rossiyskiy Kredit Bank*, 708 N.Y.S.2d 25, 31 (N.Y. 2000) (stating that New York “trust fund” doctrine provides that once company is insolvent, officers and directors stand in position of trustees, holding corporate assets in trust for creditors’ benefit); *Pereira v. Cogan*, 2002 U.S. Dist. LEXIS 8513 (S.D. N.Y., May 10, 2002) at *14-15 (holding that action for breach of fiduciary duty by corporate directors is equitable in nature and such a claim is insufficient to entitle defendants to jury trial); *In re Schipper*, 933 F.2d 513, 515 (7th Cir. 1991) (holding that debtor’s fiduciary duty to creditors is analogous to duties of corporate fiduciary). *But see Steinberg v. Kendig (In re Ben Franklin Retail Stores, Inc)*, 225 B.R. 646, 655 (N.D. Ill. 1998), *remanded by Steinberg v. Kendig (In re Ben Franklin Retail Stores, Inc.)*, 2000 W.L. 28266 (N.D. Ill. Jan. 11, 2000) (ruling that directors’ fiduciary obligation, when corporation is near insolvency, requires only that they “exercise judgment in an informed, good faith effort to maximize the corporation’s long-term wealth-creating capacity”); *Fir Tree Partners, L.P. v. MCG Communications, Inc.*, No. 114674 (Sup. Ct. of N.Y., County of N.Y., Nov. 7, 2001) (dismissing complaint alleging corporation’s board of directors owed fiduciary duty to creditors where financial statements strongly suggested impending insolvency, based on technical holding that broad “no action” clause in indenture prevented public debt holders from taking action with respect to indenture or underlying notes); *LaSalle Nat’l Bank v. Perelman*, 82 F.Supp.2d 279, 291-92 (D. Del. 2000) (ruling that although, under Delaware law, debtor in Chapter 11 bankruptcy has fiduciary duty to act in best interest of estate as a whole, including its creditors, equity interest holders and other parties in interest, officers and directors generally do not owe fiduciary duty to creditors of corporation unless corporation is insolvent). See generally Steven L. Schwarcz, *Rethinking a Corporation’s Obligations to Creditors*, 17 CARDOZO L. REV. 647, 671 (1996) (“It is not the corporation’s closeness to insolvency that is relevant, but rather whether, under the circumstances, a corporation’s contemplated action would cause insolvency, meaning that insolvency is one of the reasonably expected outcomes”); Andrew D. Shaffer, *Corporate Fiduciary-Insolvent: The Fiduciary Relationship Your Corporate Law Professor (Should Have) Warned You About*, 8 AM. BANKR. INST. L. REV. 479, 517 (2000); Christopher W. Frost, *The Theory, Reality and Pragmatism of Corporate Governance in Bankruptcy Reorganizations*, 72 THE AM. BANKR. L. J. 103, 107 (1998) (“the general rule is that directors do not owe creditors duties beyond the relevant contractual terms absent ‘special circumstances . . . , e.g., insolvency When the insolvency exception does arise, it creates fiduciary duties for directors for the benefit of creditors”); Glenn E. Siegel, Stephen J. Gordon, and Eric Steven O’Malley, *What Duty is Owed in Vicinity of Bankruptcy?*, 227 N.Y. L.J. 1 (Feb. 19, 2002); Michael D. Fielding, *Preventing Voluntary And Involuntary Bankruptcy Petitions by Limited Liability Companies*, 18

Bank. Dev. J. 51, 58 (2001) (warning that *Kingston Square Associates, supra*, “raises a warning flag, not only to anyone considering the use of a bankruptcy-remote vehicle in an LLC, but also to those employing any bankruptcy-hindrance mechanism that implicates fiduciary duties”); Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, *New Developments in Structural Finance: Report by the Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York*, 56 Bus. Law. 95, 162-66 (2000) (discussing fiduciary duties of directors and impact of *Kingston Square Associates, supra*); Gregory Varallo and Jesse A. Finkelstein, *Fiduciary Obligations of Directors of the Financially Troubled Company*, 48 BUS. LAW. 239 (1992); James R. Stillman, *Real Estate Mezzanine Financing in Bankruptcy*, Tab 24 at 3 (April 4-5, 1997) (transcript available from the American College of Real Estate Lawyers Midyear Meeting on Finance Topics).

Because LLCs are neither partnerships nor corporations – though (as noted above) they have characteristics of both – can a member or manager file a bankruptcy petition on behalf of the LLC without engaging in the unauthorized practice of law? This question was addressed and answered in *ICLNDS Notes Acquisition, LLC, supra*. In the *ICLNDS* case the court held that the debtor, ICLNDS Notes Acquisition (“ICLNDS”), an Ohio LLC, was not eligible under the Code to file a *pro se* Chapter 7 bankruptcy petition, and that ICLNDS’s manager engaged in the unauthorized practice of law by filing the petition. (It is not certain from the court’s decision whether the manager was a member of the LLC, or an independent manager. Under Ohio law, an LLC may be managed by a manager who is not a member. OHIL REV. CODE ANN. § 1705.25).

ICLNDS’s voluntary bankruptcy petition (with attached schedules) was signed by David Bruno both as “Manager” of ICLNDS and as the non-attorney petition preparer under § 110 of the Code. (Section 110 regulates the activities of non-lawyers who prepare bankruptcy petitions for compensation, and permits a lay person to assist another person with ministerial acts such as typing a petition). ICLNDS did not file an application to employ an attorney in connection with the filing. The United States trustee brought an action to dismiss ICLNDS’s bankruptcy petition, arguing that an LLC could not appear in court *pro se*, and that Mr. Bruno had engaged in the unauthorized practice of law by filing the petition. ICLNDS and Mr. Bruno neither responded to the trustee’s motion nor appeared at the hearing on the motion.

The court agreed with the trustee’s arguments, and granted the trustee’s motion to dismiss the case. The court first addressed the issue of whether an LLC constituted an entity eligible to file a bankruptcy petition under the Code. The court noted that, under §§ 109(a) and 101(13) of the Code, the debtor must be a person or a municipality, and that § 101(41) of the Code defines “person” as including individuals, corporations, and partnerships. The court then stated that although there is no specific reference in the Code to LLCs, “[u]nder the rules of construction applicable to the Code . . . the use of the term ‘includes’ is not limiting (citation omitted). In other words, individuals, corporations and partnerships are clearly eligible for relief, but other similar entities are as well”). *Id.* at 292.

The court determined that under Ohio law (as in other states), an LLC is neither a partnership nor a corporation, but a “hybrid” that has features of both a corporation and a partnership. Therefore, the court held, “[a]s corporations and partnerships are eligible to be debtors, and

because an LLC draws its character from both of those forms of doing business, an LLC is similar enough to those entities that it also comes within the definition of ‘person’ and is eligible for protection under the Code”. *Id.* at 293.

The court then turned to the issue -- which appeared to the court to be one of first impression -- of whether ICLNDS could make a *pro se* appearance in court through its manager (who was not an attorney), or could only be represented by counsel. The court stated that although, under 28 U.S.C. § 1654, individuals have the right to represent themselves without a lawyer in federal proceedings, “[t]hat right does not extend to permit them to represent other people or entities because by doing so they would be engaging in the unauthorized practice of law. The general rule is that corporations, which are artificial entities, may only appear in court through an attorney.” *Id.* The court noted that the Ohio Supreme Court had adopted a similar rule. The court also noted that this same general rule, supported by the vast majority of case law, applied to partnerships as well, i.e., partnerships must be represented by counsel in legal proceedings. Accordingly, the court ruled that whether an LLC is viewed as a corporation, a partnership, or a hybrid, it could only appear in court through an attorney. The court further noted that had ICLNDS so requested, it ordinarily would have been granted an additional period of time to obtain legal counsel. However, the court granted the trustee’s motion to dismiss the case because ICLNDS, despite being on notice, did not respond to the motion to dismiss or file an application to employ counsel.

Finally the court cited, as an additional reason to dismiss the case, the fact that Mr. Bruno’s actions in preparing and filing the bankruptcy petition and schedules constituted the unauthorized practice of law. The court stated that under Ohio law, the practice of law “includes commencing an action or proceeding in which the person is not a party (citation omitted).” *Id.* at 294. Therefore, the court held, an individual who prepares and signs a bankruptcy petition (which commences the case) other than in the individual’s own name, is commencing the case for another and has engaged in the unauthorized practice of law. (The court also noted that the unauthorized practice of law would include counseling another individual or entity on financial matters in connection with bankruptcy). The court ruled that the fact that Mr. Bruno signed the petition as a non-lawyer bankruptcy petition preparer did not protect him because § 110 of the Code “does not authorize a non-lawyer to give substantive advice and counsel about the bankruptcy process or otherwise to engage in the practice of law (citations omitted).” *Id.* at 295. The court noted that while Bankruptcy Rule 9010 authorizes a debtor’s agent, attorney in fact, or proxy to appear in court and act in the debtor’s behalf, this Rule expressly states that such representative may only “perform any act not constituting the unauthorized practice of law.” *Id.* at n.2 and n.3.

The court’s ruling in *ICLNDS Notes Acquisition* that an LLC can only appear in court through an attorney, and that a non-lawyer who prepares and files a bankruptcy petition on behalf of an LLC is engaged in the unauthorized practice of law (whether an LLC is regarded as a corporation, partnership, or hybrid entity), brings some much-needed guidance to what had heretofore been an unanswered question. The court’s analysis of this issue is sound and well reasoned, and should encourage LLCs to retain and consult counsel before making the decision to file a bankruptcy petition. State court decisions have also held that an LLC may not file a *pro se* appearance and must be represented by counsel. *See Poore v. Hollow Enterprises, C.A. No. 93A-09-005* (Del. Super. Ct. Mar. 29, 1994) (holding that, based on the contractual nature of an LLC and its limited liability, an LLC is prohibited from representing itself in a Delaware court

and must be represented by Delaware legal counsel); *Strother v. Harte*, 171 F.Supp. 2d 203, 205 (S.D.N.Y. 2001) (same); *Paton v. Old Mill Builders, LLC*, 2000 Conn. Super. LEXIS 3425 (Dec. 14, 2000) (same); *Valentine L.L.C. v. Flexible Business Solutions, L.L.C.*, 2000 Conn. Super. LEXIS 1605 (June 22, 2000) (same); *Banco Popular North American v. Austin Bagel Co., L.L.C.*, 2000 U.S. Dist. LEXIS 6979 (S.D.N.Y. May 23, 2000) (same); *International Ass'n of Sheet Metal Workers Local 16 v. A.J. Mechanical* (D.Or. June 16, 1999) (same); *Valiant Ins. Co. v. Nurse Network, LLC*, 1998 Conn. Super. LEXIS 2792 (Sept 25, 1998) (same); Elizabeth S. Miller, *The Advent of LLCs and LLPs in the Case Law: A Survey of Cases Dealing with Registered Limited Liability Partnerships and Limited Liability Companies*, Partnerships and LLCs – Important Case Law Developments 2001, American Bar Association Annual Meeting, Chicago, Illinois, August 7, 2001, p. 193 *et seq.*; Elizabeth S. Miller, *The Emerging LLC and LLP Case Law: A Survey of Cases Dealing With Registered Limited Liability Partnerships and Limited Liability Companies*, American Bar Association 2003 Annual Meeting, San Francisco, California, August 12, 2003.

The basic jurisdictional defect in *ICLNDS Notes Acquisition* was astutely raised by the trustee and prevented ICLNDS, as an LLC, from filing a *pro se* bankruptcy petition or being represented by its non-attorney manager, thereby resulting in dismissal of the case. It is puzzling why ICLNDS did not elect to cure this defect simply by hiring counsel and re-filing the petition. It is interesting to speculate as to what the result would have been if the trustee had not asserted this defect, i.e., could (or would) the court have raised and decided this issue *sua sponte*? Could or would the issue have been raised via an appeal? What if the jurisdictional issue had not been raised during the bankruptcy court proceedings, and there was a court-approved conveyance of the real property owned by ICLNDS? Would title insurance protect the grantee if it were later determined that the bankruptcy court did not in fact have subject matter jurisdiction?

It is hard to conceive of a conveyance out of bankruptcy that would not be defensible from a title standpoint, as long as the property had been conveyed in accordance with (and by the parties authorized by) the LLC's operating agreement. The grantee should be entitled to the status of a bona fide purchaser even if the LLC's bankruptcy petition had not been properly filed (which would not involve a title defect). If the members of the LLC had not all agreed to file the petition in the manner done by ICLNDS, and the dissent had been brought to the attention of the title insurer, it would need to make an informed underwriting decision before agreeing to issue the title policy. If such dissent was unknown to and had not been disclosed to the title insurer, the newly insured purchaser (or lender) might be subject to defenses raised by the title insurer for matters "created, suffered assumed or agreed to" by the insured, or known to the insured and not disclosed to the title insurer. However, if the jurisdictional issue had not been raised by anyone before the conveyance out of bankruptcy and no specific exception had been taken by the title insurer in the title policy issued to the new purchaser or lender, then any subsequently asserted jurisdictional defects would appear to be covered under the policy's insuring provisions against loss from "any defect, lien, or encumbrance on the title" and "unmarketability." A title insurer would probably not wish to create a blanket exception for the "effect of the bankruptcy" of the LLC, because the conveyance would arise out of the bankruptcy proceeding and the coverage provided would be "illusory."

The efficacy of a single-member limited liability company ("LLC") as an asset-protection vehicle has been thrown into doubt as the result of some recent cases. In *In re Albright*, 291

B.R. 538 (Bankr. D. Colo. 2003), the debtor, who filed a Chapter 13 bankruptcy petition that was later converted to a Chapter 7 liquidation, was the sole member and manager of a Colorado LLC at the time of the filing. The LLC was not a debtor in bankruptcy. The Chapter 7 trustee contended that because the debtor was the sole member and manager at the time the debtor filed bankruptcy, the trustee now controlled the LLC and could therefore sell the real property owned by the LLC and distribute the net sales proceeds to the bankruptcy estate. The debtor argued that the trustee acted only for the debtor's creditors and at most was entitled to a statutory charging order (against distributions made on account of the debtor's LLC membership interest) and could not assume management of the LLC or sell its property. The court referred to the Colorado LLC statute, under which the debtor's membership interest constituted the personal property of the member. According to the court, "[b]ecause there are no other members in the LLC, the entire membership interest passed to the bankruptcy estate, and the trustee became a 'substituted member.'" *Id.* at 540. The court also stated that, "upon the Debtor's bankruptcy filing, the Trustee now controls, directly or indirectly, all governance of that entity, including decisions regarding liquidation of the entity's assets." *Id.* at 541. The court reasoned that because there were no other members in the LLC, no written unanimous approval of the transfer was necessary, as would be the case under Colorado law if there were other members - no matter how small such other membership interests may be.

Colorado's LLC statute, similar to those in other states, provides that if the unanimous consent of all members in a multi-member LLC is not obtained, the bankruptcy estate is only entitled to receive the bankrupt member's share of the profits or other compensation that the bankrupt member was otherwise entitled to, and would not be entitled to any role in the voting or governance of the LLC. However, in a footnote the court stated that this statutory limitation "does not create an asset shelter for clever debtors. To the extent a debtor intends to hinder, delay or defraud creditors through a multi-member LLC with 'peppercorn' co-members, bankruptcy avoidance provisions and fraudulent transfer law would provide creditors or a bankruptcy trustee with recourse." *Id.* at n.9. The court rejected the debtor's assertion that the trustee should be entitled only to a charging order, finding that a charging order existed only to protect other members of an LLC, and in a single-member LLC there were no non-debtor members to protect. The court ruled that the trustee, as the sole member of the LLC, therefore controlled the LLC and could cause the LLC to sell its property and distribute the net proceeds to the bankruptcy estate, or alternatively the trustee could elect to distribute the LLC's property to the bankruptcy estate and then liquidate the property himself. However, the court did permit the debtor to make a claim for her post-petition mortgage payments to preserve the real property of the LLC, which was now an asset of the bankruptcy estate. Although the bankruptcy court's decision in *In re Albright* stands for the proposition that single-member LLCs may not provide "charging order" protection, it does not mean that these types of structures are worthless as asset-protection devices. Single-member LLCs still are valid and useful business-planning vehicles and provide significant protection for their members with respect to the "internal liabilities" of the LLC entity itself. *See, e.g., Herring v. Keasler*, 563 S.E. 2d 614 (N.C. Ct. App. 2002). In this case, the North Carolina appellate court held that an LLC interest cannot be seized and sold to satisfy a creditor's judgment; rather, the creditor is limited to an order charging the debtor's LLC interest with payment of the unsatisfied amount of the judgment with interest.

See also Associates Commer. Corp. v. Rodio (In re Rodio), 257 B.R. 699, 701 (Bankr. D. Conn. 2001) (property belonging to limited liability company itself is not part of bankruptcy estate of bankrupt member); *In re Calhoun*, 312 B.R. 380, 383-84 (Bankr. N.D. Iowa 2004)

(stating that, while an LLC is a “person” eligible to file bankruptcy, “[n]o provision in the Code permits an individual and a business to file jointly” and that “when an LLC and one of its members both seek to file a bankruptcy petition, they must do so separately”; and holding that because filing of Chapter 7 bankruptcy petition by individual debtor has no effect on property or debts of LLCs, sec. 362(a) automatic stay does not prohibit actions against separate LLC entities associated with individual debtor); 805 ILCS 180/30-1(a) (2002) (“A member is not a co-owner of, and has no transferable interest in, property of a limited liability company”). Cf. *In re Ealy*, 307 B.R. 653, 657-58 (Bankr. E.D. Ark. 2004) (ruling that bankruptcy automatic stay applied to foreclosure action against property operated by individual debtors as day care center, even though prior to debtors’ bankruptcy purchase money lender had deeded property to LLC, of which debtors were sole members, and title to property was solely in name of LLC at time of conveyance and loan; court held that debtors were “equitable owners” of property because testimony revealed that creation of LLC was result of “oversight” and misunderstanding by debtors, who had signed purchase contract as individuals and did not operate the property as an LLC at that time; court stated that “there was no intention to create a separate legal entity for the future,” and distinguished *In re Rodio, supra*, by stating that, in that case, the “court did not find sufficient equitable interest”).

Mortgage lenders should be especially careful, when lending to an LLC, to make certain that the LLC owns the property and that the individual signing on behalf of the LLC is in fact authorized to sign the mortgage and note, in order to prevent subsequent avoidance of the mortgage lien by a trustee in bankruptcy. See, e.g., *In re Moreno*, Section IV, *supra*, 293 B.R. at 785-87 (deed of trust executed by LLC instead of actual individual owner of property, even though executed by individual owner in her capacity as manager of the LLC, which owned adjacent property, provided no actual or constructive notice to bankruptcy trustee in subsequent combined Chapter 7 bankruptcy proceedings of individual owner and LLC, and enabled trustee to avoid deed of trust under section 544(a) of the Code; no equitable grounds existed for validating defective deed of trust because bank lender’s own negligence caused it to be defective).

XIII. Lender/Member Issues

Some lenders may *require* the borrower to form an LLC in connection with a loan workout (or at the inception of the loan where required by rating agencies in connection with securitized financing transactions), in order to create a “bankruptcy remote entity” by having the lender become a member (with a limited managerial right to vote) for the sole purpose of blocking any future attempt by the LLC to voluntarily file for bankruptcy. See *Exton Plaza Associates v. Commonwealth of Pennsylvania, supra*, 763 A. 2d at 522 (refinancing lender required general partnership borrower to convert to single-purpose bankruptcy-remote entity as condition to obtaining loan). The operating agreement would require unanimous consent by all members for a bankruptcy filing. Theoretically, the lender should be able to exercise its right to vote to block a bankruptcy filing because an LLC shields all members from personal liability, regardless of participation in management.

When an existing entity with significant debt seeks a workout with its creditors, it may voluntarily, or at the specific request of creditors, be reorganized as or converted to an LLC with some or even all of its creditors as owning members. This may be also be perceived as a significant business advantage to creditors who seek management input in return for partial debt

forgiveness or deferral. This is so because an LLC permits participation by members in management in a manner different than their participation in earnings and, to the extent that existing debt remains after the restructure or else is deferred through, e.g., a loan modification, an LLC's non-taxability at the entity level may lessen the likelihood that the entity debt will be reclassified as equity. *See* Richard M. Graf, *Use of LLCs as Bankruptcy-Proof Entities Widens*, *The National Law Journal*, April 10, 1995.

However, becoming a member of a borrowing LLC may be contrary to the lender's current institutional lending policies and may also expose the lender to unwanted lender liability, equitable subordination, bankruptcy, conflict-of-interest and fiduciary risks associated with possessing or exercising significant management and control rights in the borrower. The lender also risks having a bankruptcy court find that it is an "insider" of the borrower, which would extend (under § 547 (b)(4) of the Code) the bankruptcy preference period applicable to payments made by the borrower to the lender from 90 days to one year, and would also expose the lender to a possible claim by other creditors of the LLC that the lender-member's lien should be equitably subordinated, or even avoided, under sections 101(31)(c), 547(b)(4) and (5); and 510(c) of the Code. Furthermore, as a matter of general equity and/or public policy, a bankruptcy court may prohibit the use of a structure that effectively prohibits or severely inhibits the filing of a bankruptcy petition by an LLC. *See* Frederick Z. Lodge, Robert E. Michael, and Christopher S. Dewees, *Bankruptcy Remote Structures in Mortgage Loans*, *Probate & Property*, American Bar Association (May/June 1996), p. 49; Melanie Rovner Cohen and Christopher Combest, *Bankruptcy and Limited Liability Entities*, "Peas Porridge, Hot" – LLCs, Ps, LPs and Creditors, American Bar Association Section of Real Property, Probate and Trust Law, August 6, 1995, Sec. B, p. 23; Charles W. Murdock, *Limited Liability Companies in the Decade of the 90s: Legislative and Case Law Developments and Their Implications for the Future*, 56 *Bus. Law.* 499 (2001).

Title insurers may not be willing, in connection with a loan policy issued to a lender-member, to insure or defend against any claims arising out of allegations by the LLC or any of its other members that, as a result of a foreclosure action by the lender-member, the lender-member should be estopped to foreclose based on, among other things, breach of contract, breach of fiduciary duty, breach of the duty of good faith and fair dealing owed by one member to another, fraud, joint liability of the lender-member as a "joint venturer," or causation of (or contribution to the causation of) the alleged default.

In *Lawyers Title Ins. Corp. v. JDC (Am.)*, 52 F. 3d 1575 (11th Cir. 1995), the borrower and its lender formed a joint venture, which then borrowed \$38 million from the lender. The lender subsequently filed a foreclosure action against the joint venture and the Florida land trust that held legal title to the property on behalf of the joint venture. The borrower raised the affirmative defenses of breach of fiduciary duty, breach of the duty of good faith and loyalty among partners, joint liability of the lender as a joint venture partner, and estoppel. The lender and the borrower eventually settled the action, and the lender then sought indemnification from the title insurer for the costs of settlement as well as the attorneys' fees incurred in the foreclosure action. The court held that the title insurer was not liable to the lender for these costs and had no duty to defend the lender because of the exclusion in the mortgagee's policy of title insurance for matters "created, suffered, assumed or agreed to " by the insured, which exclusion applied to the claims of the lender because the claims involved actions of the insured (the lender) in entering into various relationships with the borrower. The court further held that the provision

of the title insurance policy providing coverage against the “invalidity and unenforceability of the insured mortgage” did not apply in this case, because “the provision insures against defects in the mortgage itself, but not against problems arising from or related to the underlying debt.” *Id.* at 1583. Obviously, the same legal principles could apply in connection with an LLC in which the lender has taken an ownership interest.

Title insurers may also not be willing to insure the priority of a mortgage made to an LLC of which the lender is a member because of the risk (similar to the risk that exists in connection with mortgage loans to general or limited partnerships in which the lender acquires a partnership interest) that other non-member creditors of the LLC, including subordinate lienholders, may argue that they have been unfairly prejudiced because of the special privileges the lender-member has obtained and seek to subordinate the priority of, or even eliminate, the member-lender’s mortgage lien either inside or outside of bankruptcy. Such other creditors could also argue that the stubborn refusal of a lender-member to agree to a bankruptcy filing that would be in the best interests of all creditors (as opposed to the interests of the lender-member) should not be countenanced by bankruptcy courts.

If it is determined that an LLC should be treated as a corporation under the Code, the lender-member could likely prevent an involuntary bankruptcy filing against the LLC by a member-manager by voting against it; however, if it is determined that the LLC should be treated as a partnership (i.e., a “person”) under the Code, a bankruptcy court might permit an involuntary filing against the LLC by a member-manager, similar to such a filing by a general partner of a general or limited partnership.

A lender-member could conceivably lose the benefit of the third-party lender-protection provisions of the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”), Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C.A. secs. 9601-9675 (West 1995) and other federal and state environmental statutes with respect to real property owned or operated by the LLC if, as a result of its ownership interest in the LLC, it is deemed to be a direct “owner or operator” and therefore a “responsible person” under sec. 107(a) of CERCLA instead of merely a holder a security interest that would otherwise in most cases be protected from liability under secs. 101 (2) (a) and 107 (b) of CERCLA (and similar provisions in state statutes that are based on the CERCLA legislation).

XIV. “Piercing the Entity Veil” of an LLC

Because there is no personally liable general partner or member to pursue, an LLC may be subject to the “veil piercing” doctrine. There is little case law on this issue, although there are state statutes that provide at least indirect guidance on this issue. *See, e.g.*, Colo. Rev. Stat. 7-80-107 (applying the doctrine to LLCs); California Corp. Code sec. 1710(b) (stating that LLC member liability is the same as corporate shareholder liability); Iowa Code sec. 490A.603(3) (“Nothing in this section shall be construed to affect the liability of a member of a limited liability company to third parties for the member’s participation in tortuous conduct”); Ill. Rev. Stat. Ch. 805, para. 180/10; Minn. Stat. Sec. 322b.303(s); N.D. Cent. Code sec. 10-32-29(3); Wis. Stat. Ann. Sec. 183.0304(2).

There also is relatively little case law regarding the issue of whether members or managers of LLCs have fiduciary duties (including the duties of loyalty, care and disclosure), but it is likely that members who are not managers have no fiduciary duties because they do not participate directly in the management decisions of the entity. However, members who are managers, and managers who are not members, may have fiduciary duties (similar to those owed by and among corporate directors to the corporation and its shareholders, and by general partners to limited partners) to the members who do not perform management functions. Some state LLC statutes expressly cover the issue of fiduciary duties owed by members and managers. The Uniform Limited Liability Company Act (“ULLCA”), which was prepared by the National Conference of Commissioners on Uniform State Laws and adopted by the ABA Section of Business Law in 1994, provides that members who are not managers do not have fiduciary obligations. It can be expected that courts will impose at least some public policy limitations on any attempt by an LLC, or its members or managers, to contractually modify, waive, or restrict any fiduciary duties that would otherwise be imposed on them. *See Sandra K. Miller, What Standards Should Apply to Members and Managers of Limited Liability Companies?*, 68 St. John’s L. Rev. 21 (Winter 1994).

One of the primary benefits of -- and principal reasons to organize as -- an LLC is the ability to shield the members’ personal assets from claims of outsiders and other members, i.e., the members and managers have the ability, if they so elect, to limit their liability from contract and tort claims of third parties. However, this protection may not be unlimited. At least one court (albeit in an unreported decision) has held that, under the appropriate circumstances, it may “pierce the entity veil” of the LLC and hold the members personally liable for wrongs done to third parties. In *Stone v. Frederick Hobby Associates II, LLC*, 2001 Conn. Super. LEXIS 1853, Superior Court, judicial district of Stamford-Norwalk, at Stamford, Docket No. CV000181620S (July 10, 2001) (Mintz, J.), the court found that the “instrumentality and identity rules” could be applied, under the facts of the case, to “pierce the corporate veil” of an LLC and hold the individual members personally liable. The plaintiffs, husband and wife, were both physicians. The plaintiffs had entered into a sales agreement with the defendant Connecticut LLC (which the court refers to as, and is hereinafter referred to as, “Hobby II”) in December 1999 to purchase a residence in Greenwich, Connecticut, for \$3,300,000. The home had been only partially completed by Hobby II at the time the sales agreement was executed. The sales agreement contained certain express warranties concerning the condition of the premises, and provided for the completion of certain “punch list” items within 60 days of date after the date of the agreement.

The plaintiffs subsequently filed the instant lawsuit, alleging numerous and substantial defects in design, materials and workmanship at the subject property, and alleging further that Hobby II had failed to timely complete all the punch-list work set forth in the sales agreement. The plaintiffs’ complaint further stated that Hobby II had, on or near the January 25, 2001, closing date for the purchase of the premises, transferred substantially all of its assets, including the proceeds from the sale of the subject property, to another Connecticut LLC, Frederick Hobby Associates, LLC (which the court refers to as, and is hereinafter referred to as, “Hobby I”) and to Frederick L. Hobby, III (hereinafter referred to as “Hobby”) and Sally M. Leiendecker (hereinafter referred to as “Leiendecker”). (Hobby and Leiendecker were the sole members of Hobby II). The plaintiffs’ complaint contained nine counts for relief, including breach of express warranty, breach of contract, violation of the

Connecticut Uniform Fraudulent Transfer Act, and piercing the corporate veil of Hobby II so as to hold Hobby I, Hobby, and Leiendecker personally liable.

After a court hearing on the merits of the case, the plaintiffs filed a “prejudgment remedy application.” Under Connecticut law, such an action enables the plaintiff in a lawsuit to attach and preserve the assets of the defendant while the matter is being litigated, if the court determines that there is probable cause to sustain the validity of the plaintiff’s claim. The court concluded, after hearing testimony and examining the plaintiffs’ and defendants’ pleadings and proofs, that such probable cause existed and granted the plaintiffs’ application for the statutory prejudgment remedy. In connection with this relief, the court further granted the plaintiffs’ motion for disclosure of the assets of Hobby I, Hobby, and Leiendecker.

The court noted that because it found that the plaintiffs were entitled to the pre-judgment relief requested, ordinarily it would not need to specifically address their request to “pierce the corporate veil” of Hobby II. However, the court stated that “[t]he issue of whether the assets of Frederick L. Hobby, III, Sally M. Leiendecker and Hobby I may be reached upon the theory of piercing Hobby II’s corporate veil is critical to the plaintiffs’ application, especially in light of Frederick L. Hobby, III’s testimony at the prejudgment application hearing indicating that Hobby II currently has no assets.” *Id.* at *24 n. 17.

The court further noted that Connecticut’s LLC statute, Conn. Gen. Stat. § 34-133(a), provides (with certain exceptions) that a member or manager of an LLC is not liable for any debt, obligation or liability of the LLC (or any other member, manager, agent or employee of the LLC) to any third party, whether arising by contract, tort, or otherwise, solely by reason of being a member of manager of the LLC. However, the court stated that “[t]he limitation on liability provided by incorporation or the formation of a limited liability company is not . . . without boundaries.” *Id.* at *26. The court held that the same rationale that applies in connection with piercing the corporate veil also applies in the case of an LLC, but stated that “[t]he veil should . . . only be pierced under extraordinary circumstances.” *Id.* at *28 (citation omitted). The court stated further that “[t]he instrumentality and identity rules may be applied in order to ‘pierce the corporate veil’ of a limited liability company.” *Id.* at *29 (citations omitted).

According to the court, the instrumentality rule requires proof of three elements: 1. complete domination and control of both the entity’s policy and business practices; 2. use of such control to commit fraud or wrong, breach of a legal duty, or a dishonest or unjust act (such as using such control to avoid personal liability previously assumed by an individual); and 3. that the aforesaid control and breach of duty must proximately cause the injury or loss. With respect to the identity rule, the court stated that the “[t]he identity rule is generally employed in a situation where two corporations or companies are, in reality, controlled as one entity because of common owners, officers, directors, members or shareholders, and because of a lack of observance of corporate or company formalities between the two entities.” *Id.* at 30-31 (citation omitted). The court further stated that “in an appropriate case . . . the rule may also be employed to hold one or more individuals liable,” and that “[o]f paramount concern is *how* the control was *used*, not that it existed. *Id.* at *31-32 (emphasis in text).

Turning to the facts of the instant case, the court found that Hobby and Leiendecker were the sole members of Hobby II, and that Hobby II's office was located in Hobby's private home (although Hobby II did not pay any rental for such space). The court also noted that Hobby II never had any assets other than the residential property that the plaintiffs purchased from Hobby II and which was now owned by the plaintiffs. The court also was particularly disturbed by a statement by Mr. Gold, the attorney who formed Hobby II on behalf of Hobby and Leiendecker and continued to act as Hobby II's attorney. Mr. Gold's statement was made during a meeting held between the parties in an attempt to resolve their differences in May of 2000 (which meeting the court found was not part of "settlement negotiations," which would have enabled Mr. Gold to claim the statement was privileged). Mr. Gold told the plaintiffs, at this meeting, to "go ahead and sue us [Hobby II]. There is no money in [Hobby II]. Why do you think we set it up as an LLC in the first place?" According to the court, "[t]his . . . statement evidences an intent on the part of the individual defendants . . . to use the limited liability company as a shield in order to avoid responsibility for contractual obligations owed to the plaintiffs." *Id.* at *33. The court further found that Hobby II had used a number of other, often confusing, names to describe Hobby II (such as "Frederick Hobby Associates") and that the Connecticut transfer tax return executed in connection with the sale of the subject property stated that the grantor was not an LLC and was signed by Hobby in his individual capacity.

Based on the totality of the evidence, the court concluded that each of the necessary elements of the instrumentality rule had been established. According to the court, "[t]he plaintiffs have demonstrated that that Frederick L. Hobby, III and Sally M. Leiendecker exercised such domination over Hobby II that in essence, the limited liability company had no mind, will or existence of its own." *Id.* at *38. The court rejected Hobby II's argument that a mere breach of contract does not support invocation of the instrumentality rule to pierce the corporate veil of an entity, stating that the rule only requires that the court find "the defendants committed an unjust act in contravention of the plaintiffs' legal rights," and stating further that "[i]n this case, probable cause supports the finding that Hobby II committed an unjust act in contravention of the plaintiff's legal rights by using the privilege of doing business in the limited liability form as a cloak to evade contractual obligations to the plaintiffs." *Id.* at *38 n.21. The court also rejected Hobby II's assertion that Hobby I, Hobby, and Leiendecker could not be held liable because the plaintiffs knew they were dealing with an LLC and had not alleged that they were fraudulently induced to enter into the contracts with Hobby II.

The court found that the evidence also demonstrated probable cause for the court to apply the identity rule. This was so, the court ruled, because "Frederick L. Hobby, III and Sally M Leiendecker used Hobby II interchangeably with their own personal identities and with identities of other entities under their control, and failed to observe formalities for the limited liability company. The names of these other entities, whether real or fictitious, represent entities which are, in reality, controlled as one entity because of common owners or members and because of a lack of observance of formalities between the entities." *Id.* at *39. The court reasoned that because there was such a unity of ownership and interest, Hobby II's existence as a separate entity had never really existed or had been terminated, and the existence of Hobby II as an LLC with a separate identity "would only serve to defeat justice

and equity by permitting the individual defendants to escape liability arising out of a ‘shell’ operation conducted for their benefit.” *Id.*

The court held that, under the tests enunciated in both the instrumentality rule and the identity rule, probable cause existed to support the plaintiffs’ breach-of-contract claims and their request to pierce the corporate veil of Hobby II to reach the assets of Hobby I, Hobby, and Leiendecker. The court therefore granted the plaintiffs’ application for the Connecticut prejudgment attachment remedy, in the amount of \$300,000, and further granted the plaintiffs’ motion for disclosure of the assets of Hobby I, Hobby, and Leiendecker.

See also Cognex Corp. v. VCode Holdings, Inc., Slip Copy, 2006 WL 3043129 (D. Minn., Oct. 24, 2006), at * 10-11, where the Minnesota District Court addressed the issue of application of the alter-ego theory to Illinois LLCs. VCode was a single-member Illinois LLC with no employees of its own. Acacia Acquisitions (“Acquisitions”) was a corporation and the single member of the LLC. In turn, Acquisitions was wholly owned by Acacia Research Corporation (“Research”). The court determined that Acquisitions and Research had nearly identical officers performing similar functions. The court also found that because no natural persons were part of VCode, all operational decisions on behalf of the LLC were in fact made by Acquisitions. The court noted that press releases and consolidated tax returns indicated that Research acted on behalf of VCode. The court further noted that Acquisitions was a holding corporation wholly owned by Research and had no assets other than its stakes in various subsidiaries, and that the officers of Acquisitions and Research were virtually identical. Therefore, the court held that VCode was the alter ego of Research, and the actions of VCode could be imputed to Research. The court permitted the plaintiff to proceed with its action for declaratory judgment against Research in connection with a patent dispute. Interestingly, the Minnesota District Court cites no other Illinois case on the application of alter-ego theory to Illinois LLCs. The parties to the case suggested that the court adopt a multiple-factor alter-ego test first adopted by the Tenth Circuit in *Taylor v. Standard Gas & Elec. Co.*, 96 F.2d 693, 704-05 (10th Cir. 1938), but the court stated that “[t]his test is infrequently employed by Illinois courts, and there is little inclination that its use is currently favored.” *Id.* at *9. The court further noted that “[a]t the time that the test was developed, the law of business organizations had yet to recognize statutory limited liability companies,” and “the underlying focus is whether the parent exercises such control that the parent and subsidiary are indistinguishable.” *Id.* at *10. But, as noted by Professor Pat Randolph on his DIRT internet listserv “Daily Development” (March 10, 2007):

Acquisitions was a simple holding company, and conducted no business. Applying alter ego principles to that corporation seems appropriate. VCode did have a business. And it was incorporated to carry out that business. And the law of Illinois permitted the incorporation of single owner businesses. One would assume that, in a business with a single owner, that owner would have significant control over the affairs of the business. What is the meaning of the decision to permit incorporation of single owner businesses if not to permit business owners to enjoy the benefits of limited liability with respect to the affairs of that business, even though they in fact control the businesses decisions?

Cf. State ex rel Petro v. Mercomp, 167 Ohio App. 3d 64, 72 (2006) (holding that control by an individual who was the single shareholder of a corporation rendered that individual personally

and strictly liable for corporation's violations of solid waste regulations based on decisions made in the course of the corporation's business).

For other cases permitting the piercing of the LLC entity veil, see *Emma Rosina, LLC v. Bilides Bldg. & Excavating, LLC*, 2003 Conn. Super. LEXIS 1868 (July 1, 2003) (unpublished) (ruling that allegations in plaintiff's complaint sufficiently pleaded requirements of instrumentality rule with respect to piercing entity veil of LLC); *Nadler v. Grayson Constr. Co.*, 2003 Conn. Super. LEXIS 1008 (April 15, 2003), at *9-11 (holding that corporate veil-piercing doctrine is applicable to LLC and its members, and that determination of whether to disregard protections afforded an LLC and pierce entity veil requires same analysis as when dealing with stock corporation); *Turner v. Bulduc (In re Crowe Rope Indus., LLC)*, 307 BR. 1, 7 (Bankr. D. Me. 2004) (under Maine law, standard for piercing veil of LLC is same as for corporation; plaintiff must establish that defendant abused privilege of separate corporate entity and an unjust or inequitable result would occur); *FILo America, Inc. v. Olhoss Trading Co. Inc.*, 321 F.Supp. 2d 1266, 1269-70 (M.D. Ala. 2004) (veil-piercing doctrine applies to LLCs; fraudulent purpose in conception or operation of LLC is valid reason to pierce entity veil); *Stinky Love, Inc. v. Lacy*, 2004 Cal. App. Unpub. LEXIS 157497 (Cal. App. Aug. 13, 2004) (permitting piercing of "corporate veil" and holding LLC's founder and CEO personally liable on judgment against LLC); *Hollowell v. Orleans Regional Hospital LLC*, 217 F.3d 379, 385-388 (5th Cir. Pa. 2000), *reh'g denied en banc*, 232 F.3d 471 (3rd Cir. Pa. 2001) (permitting plaintiff to pierce LLC entity veil under Louisiana "totality of the circumstances" test, which did not require finding of fraud); *Kaycee Land & Livestock v. Flahive*, 46 P.3d 323, 325, 327-29 (Wyo. 2002) (ruling that no reason exists in law or equity to treat LLC differently from corporation when considering whether to pierce entity veil to prevent fraud, injustice or inequity and that remedy is permissible under Wyoming LLC Act); *Bastan v. RJM & Assoc.*, 2001 Conn. Super. LEXIS 1605 (June 4, 2001), at *8 (applying alter ego theory to permit piercing of LLC entity veil of member-managed LLC, and analogizing situation of controlling member to sole shareholder who ignored corporate obligations); *Peinado v. Barnett*, 2001 Cal. App. Unpub. LEXIS 1924 (Nov. 6, 2001), at *9-11 (affirming judgment finding California LLC members personally liable under alter ego theory); *Estate of Countryman v. Farmer's Coop. Ass'n*, 679 N.W.2d 598, 604 (Iowa Sup. Ct. 2004) ("The [Iowa LLC Act] does not insulate a manager from liability for participation in tortious conduct merely because the conduct occurs within the scope and role as a manager"); *Simon v. JP Morgan Chase Bank (In re Brentwood Golf Club, LLC)*, 2005 Bankr. LEXIS 1609 (Bankr. E.D. Mich. Aug. 30, 2005) (piercing veil of LLC because two businesses were inextricably linked and all corporate formalities had been disregarded); *Jarvis v. Wells Fargo Financial (In re Jarvis)* (Bankr. N.D. Ohio 2004) (holding that for all practical purposes debtors and LLC had no separate existence in context of analyzing effectiveness of notice under UCC filing). See also *Business Loan Express, LLC v. Pak*, 2004 U.S. Dist. LEXIS 12807 (D. Md. July 9, 2004) (setting aside transfer as fraudulent conveyance where, while confessed judgment was pending against them, transferors transferred property to new LLC formed by transferors' daughter, who then sold property and wired proceeds to third party also related to transferors); *Intuition Consolidated Group v. Dick Davis Publishing Co.*, 2004 U.S. Dist. LEXIS 4821 (March 25, 2004) (finding proper allegation of fraudulent conveyance to LLC where, shortly after executing lease, corporation transferred all of its business assets to LCC that operated under same name) .

Notwithstanding recent case law permitting the piercing of the LLC entity veil, other courts determined that the necessary factors to permit piercing of the LLC entity veil were not present. *See, e.g., Corole v. Ochsner Clinic, L.L.C.*, 811 So.2d 92, 2002 La. App. LEXIS 547 (La. Ct. App. 4 Cir. 2002), at *9 (holding that under facts of the case, plaintiff “failed to make allegations sufficient to require an inquiry into whether the limited liability veil should be pierced”); *In re Multimedia Communications Group Wireless Associates of Liberty County, Georgia*, 212 BR. 1006, 1010-11 (Bankr. MD Fla. 1997) (refusing, under Florida three-part test for piercing corporate veil, to find commonly owned LLCs and LLC members personally liable for bankrupt corporation’s liabilities; and holding that there was not fraudulent purpose and that various entities maintained separate identities); *Tom Thumb Food Markets, Inc. v. TLH Properties, Inc.*, No. C9-98-1277, 1999 WL 31168 (Minn. App. Ct. Jan. 26, 1999) (unpublished) at *9-10 (refusing to impose personal liability on LLC members for breach of obligations under lease to plaintiff or to pierce entity veil because LLC members’ conduct was not fraudulent and plaintiff did not have “clean hands”); *Sheppard v. River Valley Fitness One, L.P.*, 2002 DNH 116, 2002 U.S. Dist. LEXIS 10985 (June 14, 2002), at *5 (finding that alleged oral statement by individual member of LLC that he was sole general partner of limited partnership of which LLC was general partner, was not in and of itself an abuse of the entity form of the LLC); *Essex Real Estate Group v. River Works L.L.C.*, 2002 U.S. Dist. LEXIS 14564 (N.D. Ill., August 7, 2002), at *14 (holding that plaintiff’s “conclusory allegations” did not suggest that necessary elements were present to establish that the LLC defendant was mere “instrumentality” of individual defendants; and that “a ‘wrong’ beyond intentional asset and liability-shifting is required”); *Gallinger v. North Star Hosp. Mut. Assurance*, 64 F.3d 422, 427-28 (8th Cir. 1995) (Judge Heaney, dissenting) (holding that veil of Bermuda LLC could not be pierced where there was no finding of injustice or fundamental unfairness); *Ditty v. CheckRite*, 973 F.Supp. 1320, 1336 (D. Utah 1997) (finding that plaintiff could not pierce entity veil of LLC under alter ego theory where there was no unity of interest and ownership, and no evidence of fraud, injustice, or inequity); *New Horizons Supply Co-op v. Haack*, 224 Wis. 644, 1999 Wisc. App. LEXIS 108 (Wis. Ct. App. 1999) (unpublished), at *8, *10-12 (although noting that fact that LLC was being taxed as partnership not sufficient to find member personally liable, judgment for plaintiff was affirmed because when LLC dissolved, defendant failed to take appropriate steps under Wisconsin statute to shield herself from personal liability for LLC’s debts); *Advanced Tel. Sys. v. Com-Net Prof’l Mobile Radio, LLC*, 59 Pa. D&C 4th 286 (2002) (refusing to pierce LLC entity veil based on alter ego theory where plaintiff knew that it was dealing with LLC with limited liability and evidence did show that entity was misused were misused or the necessary formalities were ignored); *Bowen v. 707 on Main*, 2004 Conn. Super. LEXIS 375, at *2 (Conn. Super. Ct. 2004) (to hold LLC members liable for breach of contract, additional factors must be proven to “pierce the corporate veil” of an LLC); *Birdsell v. Fort McDowell Sand & Gravel (In re Sanner)*, 218 B.R. 941, 947 (Bankr. D. Ariz. 1998) (attempt to pierce corporate veil was not supported by credible evidence; LLC agreement was signed by individual in representative capacity)..

See generally C. Leslie Banas and Jonathon Block, *Caveat Member: Courts Begin to “Pierce the Entity Veil,” Imposing Personal Liability on all Members*, 29 MICH. REAL PROP. REV. 15 (2002); Susan Muller Rogge, *Casnote: Hollowell v. Orleans Regional Hospital: Piercing the Corporate Veil of a Louisiana Limited Liability Company and Successor Liability*, 47 LOYOLA L. REV. 923 (2001); Warren H. Johnson, *Limited Liability Companies*

(LLC): *Is the LLC Liability Shield Holding Up Under Judicial Scrutiny?*, 35 NEW ENG. L. REV. 177 (2000); Rebecca J. Huss, *Revamping Veil Piercing For All Limited Liability Entities: Forcing the Common Law Doctrine Into the Statutory Age*, 70 CIN. L. REV. 95 (2001); Chad Brigham, *Comment: Just How Limited is the Illinois Limited Liability Company?*, 26 ILL. U.L.J. 53 (2001); Shaun M. Klein, *Comment, Piercing the Veil of the Limited Liability Company, from Sure Bet to Long Shot: Gallinger v. North Star Hospital Mutual Assurance, Ltd.*, 22 IOWA J. CORP. L. 31 (1996); David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Corporate Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company*, 51 OKLA. L. REV. 427 (1998); James R. Cambridge, *Piercing the Veil of a Michigan Limited Liability Company*, 23 MICH. BUS. L. J. 18 (2003); Karin Schwindt, *Comment, Limited Liability Companies: Issues in Member Liability*, 44 UCLA L. REV. 1541 (1997); Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1 (1997); Rachel Maizes, *Limited Liability Companies: A Critique*, 70 ST. JOHN'S L. REV. 575 (1996); Eric Fox, *Note, Piercing the Veil of Limited Liability Companies*, 62 GEO. WASH. L. REV. 1143 (1994) John P. Glode, *General Law Division: Piercing the Corporate Veil in Wyoming: An Update*, 3 WYO. L. REV. 133 (2003); Robert R. Keatinge, et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 445 (1992); Curtis J. Braukmann, *Comment, Limited Liability Companies*, 39 KAN. L. REV. 967, 992 (1991); Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 403 (1994); Robert R. Keatinge, et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 445 (1992); Curtis J. Braukmann, *Comment, Limited Liability Companies*, 39 KAN. L. REV.. 967, 992 (1991); Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 403 (1991).

Although the court in *Stone v. Frederick Hobby Associates II, LLC, supra*, believed that the conduct of the individual defendants in this case justified its conclusion that the plaintiffs were entitled to “pierce the entity veil” of the LLC of which the individual defendants were the sole members, no specific finding of actual fraud on the part of the individual defendants had been made by the court. There probably is no good reason why the “piercing the corporate veil” doctrine should not be applied to LLCs, at least where the extraordinary fact situations warrants its applicability. But is it really the intention of LLC statutes to abrogate the limited liability feature of an LLC (which is one of the primary benefits of and reasons for forming an LLC) -- even if the members may have engaged in egregious conduct -- when only a contractual violation has been established and the party alleging misconduct on the part of the LLC members at all times knew that the party it was dealing with was an LLC? Attorneys who are engaged in the practice of forming and advising LLCs should read this decision (and the additional cases cited above) carefully and determine whether a court in a particular jurisdiction might reach the same conclusion under similar factual circumstances. Other lessons for attorneys from the cases described above: carefully observe applicable LLC statutory and organizational formalities (which should be kept to a minimum contractually, to the extent possible); establish a clear and separate identity for the LLC apart from its constituent members (including a separate office, stationery, books, and assets); clearly designate and name the LLC as the entity entering into and executing (and solely authorized to enter into and execute, by virtue of the designated individual in his, her or its representative capacity) business agreements, contracts and other documents intended to bind

and benefit the LLC; avoid intentional “undercapitalization” of the LLC and deliberately stripping the LLC of its assets to avoid creditors; make no assurances or representations, as an LLC member, as to the financial resources or strength of the LLC; and (perhaps most important) don’t dare a party dealing with the LLC to sue it by asserting, e.g., that “the LLC doesn’t have any money or assets you can reach, and that’s the reason we formed it.”

XV. The Series LLC

In 1996, the DLLC Act was amended to permit an LLC agreement to provide for the establishment of designated series of specified property or operations with separate business purposes or investment objectives, such that the debts, liabilities and obligations relating to a particular series would be enforceable only against the assets of such series and not against the assets of the LLC generally or the assets of any other series. *See* Del. Code Ann. tit. 6, §18-215(a) and (b). (In Illinois, the Secretary of State's Business Law Advisory Committee has been studying the concept of series LLCs for more than two years, and a draft bill amending the Illinois LLC Act to permit formation of series LLCs will be submitted to the 2005 session of the Illinois General Assembly.)

Each series is essentially a separate “cell” or “mini-LLC” within the LLC itself, with separate members, managers, assets and liabilities, and business interests. The LLC and not the series will be treated as the legal entity under Delaware law. Theoretically, the LLC could avoid the debts of the LLC altogether by allocating all the LLC assets to the various series within the LLC.

The assets of a particular series are protected from enforcement action against the assets of the LLC or any other series if (1) the LLC agreement provides for the establishment of one or more series, (2) separate and distinct records are maintained for each series and its assets are accounted for separately from the other assets of the LLC or any other series (and the LLC agreement so provides), and (3) notice of such limitation of liability is set forth in the LLC’s certificate of formation. *See* Del. Code Ann. tit. 6, §18-215(b). However, a member or manager may agree to be obligated personally for any or all of the debts, obligations, and liabilities of one or more series. *See* Del. Code Ann. tit. 6, §18-215(c).

Consistent with the general LLC goals of freedom of contract and flexibility, the LLC agreement can create numerous series within the LLC to accomplish diverse business objectives. The LLC agreement can provide for the future creation of additional classes or groups of members or managers not previously outstanding within a series, and also can provide for the taking of any action, including the amendment of the LLC agreement, without the vote or approval of any member or manager or class or group of members or managers. *See* Del. Code Ann. tit. 6, §18-215(d).

Furthermore, unless otherwise provided in the LLC agreement, any event that causes a member to cease to be associated with a series will not, in itself, cause such member to cease to be associated with any other series or terminate the member’s interest in the LLC, or cause the termination of the series even if the member was the last surviving member associated with the particular series. *See* Del. Code Ann. tit. 6, §18-215(i).

Upon application of a manager or member of a series, the Delaware Court of Chancery may decree the termination of the series “whenever it is not reasonably practicable to carry on the business of the series in conformity with a limited liability agreement.” *See* Del. Code Ann. tit. 6, §18-215(l). The DLLC Act also permits a foreign LLC that is properly registered to do business in the State of Delaware to provide, in its LLC agreement, for the establishment of a designated series of members, managers or LLC interests (provided that the application for registration as a foreign LLC so states) and for the limitation of liability for the debts, liabilities and obligations of a particular series to the assets of that series. *See* Del. Code Ann. tit. 6, §18-215(m).

The statutory scheme created by §18-215 of the DLLA radically changes how an operating entity can protect its assets from creditors. Each of the series of assets in a series LLC can operate independently of the LLC in general and any other series, and avoid their liabilities. The principals of an LLC should be able to freely transfer assets and ownership interests from one series to another. However, there are still potential risks -- and uncertainty -- with respect to such issues as tort-liability protection, fiduciary duties, avoidance of sales taxes and documentary transfer taxes, and property reassessments.

The following constitute some of the unresolved issues raised by the creation of series within an LLC:

1. May an asset or group of assets be used in connection with the business activities of two or more series within an LLC? Can an allocation of values and liabilities be established, and if so on what basis? (For example, what if the activities of several series are conducted from the same premises?).
2. Must actual title to an asset or assets of a particular series be held in the name of the series or is it permissible simply to designate the particular series assets in the books and records of the LLC?
3. Since the only required notice of limitation of liability of the series appears in the LLC’s certificate of formation filed with the Delaware Secretary of State’s office, creditors doing business with the LLC may have no actual knowledge of such limited liability unless they are so informed by members or managers of the LLC (at some level, such members and managers may have an affirmative duty not to deliberately conceal such liability limitations or mislead creditors). Potential creditors must therefore carefully review the LLC’s filed certificate of formation, and perhaps require that a specified manager or member (or managers or members) personally guarantee the series’ debt to the creditor.
4. The limitation-of-liability provisions of a series LLC may be challenged under the laws of a foreign jurisdiction if the LLC has operations outside Delaware.
5. Does the creation of more than one series within an LLC constitute a “partnership” for tax purposes? Based on separate allocations of sharing ratios and economic benefits and risks by two or more individuals or entities among separate series, the IRS may argue that there are “two tax partnerships” rather than a “single tax partnership.”

6. Series LLCs may be established in an attempt to avoid sales taxes, which may lead to challenges by state taxing authorities. For example, California imposes a tax on the gross receipts of an LLC (capped at \$4,500 per year). California also imposes an \$800 minimum income tax on each LLC.
7. In connection with sales and purchases of property (including like-kind exchanges under § 1031 of the Internal Revenue Code), tax planners may attempt to avoid unfavorable income-tax, transfer-tax, and sales-tax consequences by transferring the property and the purchase price (or separate properties that otherwise do not meet the time or type-of-property constraints of IRC § 1031) to a single-member LLC. The LLC would then establish two series, one of which contains as its sole asset the property contributed by the seller (of which the buyer becomes the sole member or the holder of a 99% interest), and the other of which includes as its sole asset the purchase price or the otherwise non-complying “like-kind” property (of which the seller or exchanger becomes the sole member or the holder of a 99% interest). Although some tax planners may argue that such a transaction is merely a permissible contribution of assets to an LLC that should be taxable as a “single partnership” with special allocations, others may argue that the transaction is in substance a sale or exchange and is subject to applicable income and sales taxes. With respect to taxes on the sale or exchange of real property, many jurisdictions exempt transfers to a wholly owned LLC. However, state taxing authorities may seek to challenge such transfers (whether or not transfers to LLCs are statutorily permissible), or else act to legislatively close the perceived “loophole” by amending state statutes to tax transfers into and out of series LLCs. *See Terence Floyd Cuff, Series LLCs and the Abolition of the Tax System, Business Entities, p.26 (2000).*
8. Will the limited-liability provisions with respect to each series protect the series (or the LLC) with respect to environmental contamination of series or LLC property?
9. The interplay between the federal Bankruptcy Code and Delaware corporate and LLC law may create some interesting issues. For example, will a series be eligible (apart from the LLC) to file (or have filed against it) a bankruptcy petition? Will LLC series be subject to separate claims classification or entitled to vote separately on plan confirmation? Will fraudulent-conveyance issues arise with respect to inter-series guarantees? Will § 1111(b) of the Bankruptcy Code (which allows a secured creditor with a nonrecourse loan to elect to treat its claim as being with recourse against the debtor) apply to creditors whose recourse is limited to the assets of a particular series? Will multiple committees (and consultants and professionals) be required for LLCs with more than one series? Will separate counsel be required for each series (as opposed to the LLC’s counsel) to protect the separate interests of each series?

Although the use of a series LLC appears to offer unlimited planning opportunities, many legal and tax issues remain unresolved. There is not as yet an established body of case law regarding these issues, and the attorneys, consultants and investors who establish series LLCs should proceed cautiously and conservatively. The principals of the

LLC should obtain expert tax and legal advice when forming one or more series within the LLC as provided in the DLLC Act. With respect to real estate investments, the segregation of assets may be problematical where the LLC is the sole title-holder of record. While separate mortgages with respect to each series could be recorded, title would necessarily remain in the LLC as the recognized legal entity. Perhaps the loan documents could limit recourse with respect to a particular property to a particular series. However, with respect to “carveouts” to nonrecourse provisions in the loan documents with respect to specific “bad acts” of the LLC borrower or a particular series, the lender should require that the LLC agreement be amended to specifically provide for the personal liability of a designated member or manager (or members or managers) for such carveouts.

As one commentator has noted, “[a] significant benefit of the series LLC is the ability to transfer members, change membership ownership interests and transfer assets without resorting to external transfers, conversions, and mergers. Such internal transfers would avoid . . . transfer, conversion and merger issues . . . including transfer tax and real property tax reassessments. The series LLC is an intriguing device and its evolution should be carefully monitored for application to real estate investments.” Robert R. Nix II, *Capturing the Benefits of the Limited Liability Company – Use of Transfers, Conversions, Mergers and Legislated Enhancements*, The ACREL Papers, The American College of Real Estate Lawyers (2000), at Tab 13. *See also* Craig A. Gerson, *Memorandum: Taxing Series LLCs*, TAX MANAGEMENT MEMORANDUM (BNA) (2004).

Other states have become interested in enacting (or already have enacted) legislation to amend their statutes to permit the formation of series within the LLC. For example, in Illinois the Secretary of State’s Business Law Advisory Committee studied the concept of series LLCs for three years, and a draft bill amending the Illinois LLC Act to permit formation of series LLCs was submitted to the 2005 session of the Illinois General Assembly. The bill, S.B. 0504 (2005), which was enacted into law on August 16, 2005, amends the Illinois Limited Liability Company Act, 805 ILCS 180/1-1 et seq., by adding a new section, 805 ILCS 180/37-40 . This new section provides that an LLC’s operating agreement may establish a designated series of members, managers or LLC interests having separate rights, powers, or duties with respect to specified property or obligations of the LLC or profits and losses associated with specified property or obligations, and to the extent provided in the operating agreement, any such series may have a separate business purpose or investment objective. It also establishes the procedures for management, operation, and dissolution of a series, and further specifies the applicable fees for filing articles of organization, annual reports, and certificates of designation for a series of a limited liability company. The Illinois legislation, though similar in most respects to the series LLC provisions in the DLLC Act, differs somewhat in that unlike Delaware, which does not require the umbrella LLC to file any document with the Secretary of State whenever it chooses to add a new series, it requires the umbrella LLC to file a separate “certificate of designation” to establish the existence of an individual series within the company. (The initial notice of the limitation on liabilities of a series in the LLC’s certificate of formation is “sufficient for all purposes” whether or not the LLC has established any series at the time the certificate is filed. ~~§~~ DEL. CODE ANN. TIT. 6, §18-215(b)). The same certificate of designation could also be used to terminate the series;

thus the public would know if they were dealing with a series as opposed to the umbrella LLC and the Secretary of State's office would always have current documents revealing the ownership of the series. *See* Lin Hanson, *What Series LLCs Can Do For You*, 92 ILL B.J. 648 (Dec. 2004). (Note: the Delaware Division of Corporations has developed new procedures and data-entry fields to identify series LLCs and distinguish them from other LLC filings, which makes it possible, with respect to filings after July 19, 2005, to request and obtain a certificate of good standing for a specific series LLC, as well as a certified copy of a conversion to a series LLC or the filing history for a specific series LLC). The new Illinois legislation also provides (unlike the DLLC Act) that each series shall (to the extent set forth in the articles of organization) be treated as a separate entity and "may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company under this Act." *Id.* at sec. 37/40(B).

The new Illinois legislation states, however, that "[t]he name of the series with limited liability must contain the entire name of the limited liability company and be distinguishable from the names of the other series set forth in the articles of organization." *Id.* at sec. 37/40(C). Based on this provision, it would appear that while a Delaware series of an LLC would hold title in the name of the "master" LLC with the following type of designation: "held [as property of] [for the benefit of] _____, a series of _____ LLC," in Illinois the series perhaps could hold title in its own name with the following type of designation: "as series _____ of the _____ LLC." *See* Lin Hanson, *What Series LLCs Can Do For You*, 92 ILL. B.J. 648 (Dec. 2004).

At least eight other states -- Iowa, Minnesota, Nevada, North Dakota, Oklahoma, Tennessee, Utah, and Wisconsin -- have enacted revisions to their respective LLC statutes to specifically authorize the formation of series LLCs. *See* IOWA CODE § 490A.305; 20 C MN PRAC 322B.03; NEV. REV. STAT. § 86.296; ND ST 10-32-02 (2005); OKLA. STAT. TIT. 18, §2054.4; TCA § 48-249-309; UCA 1953 § 48-2c-606; and WIS. STAT. § 183.0504. These statutes contain language similar to the series LLC provisions of the DLLC Act and the proposed Illinois statutory revisions described above (except for the "certificate of designation" requirement in the proposed Illinois legislation), and permit a foreign LLC that provides for the designation of series to register to do business in the state (subject to full disclosure of such fact in the application for registration as a foreign LLC).

A separate series within a Delaware LLC cannot hold title in its own name because it is not a separate legal entity for ownership purposes under the DLLC Act, i.e., the statutory language regarding series LLCs does not speak in terms of "separate ownership" but rather in terms of segregating assets and liabilities (and management) within the LLC. This provides for separate "charging" of liabilities within specific series if the operating agreement and certificate of formation for the "master" LLC so provide, separate records are kept, and separate accounts are maintained for each series. Theoretically, all the assets of an LLC could be put into one (or more) series, and all the liabilities of an LLC into another series (or more than one series). However, there is no case law yet in Delaware on series LLCs, and there could be a "substantive consolidation" claim made, or the court could undo the

arrangement if there is no valid business reason. Also, because it is unclear as to if (and to the extent) other states will uphold the validity of the Delaware series structure, it would be prudent to be conservative on title issues involving series LLCs. The structure may be used in an attempt to avoid real property transfer taxes, by simply shifting ownership of LLC assets to separate series within the LLCs, which have different members and management. However, the Delaware transfer-tax statute applies to any transfer of more than 75% of the beneficial interests in an entity.

The certificate of formation or operating agreement would establish the authority of the manager of a particular series of a Delaware LLC to bind the master LLC (subject to applicable series liability limitations) and execute documents (including deeds, mortgages, etc.) on its behalf. But (as mentioned above) the "master" LLC should be the title holder (or mortgagor), with the designation set forth above. Of course, when dealing with the Delaware series LLC structure, careful attention must be paid to the certificate of formation and the operating agreement, and the ability to shift assets and liabilities among different series.

In light of the foregoing, unless there is some overriding business purpose, many practitioners believe it may be prudent to just create separate LLCs instead of separate series within the master LLC for real-estate ownership purposes. *See generally* John C. Murray, *A Real Estate Practitioner's Guide to Delaware Series LLCs (with Form)*, 21 PRAC. REAL EST. LAW. 23 (Nov. 2005) (an updated version of this article is available at <http://www.firstam.com/listReference.cfm?id=5574>).

XVI. Conclusion

Uniform legislation and standard practices, including title standards, will undoubtedly be developed over time with respect to LLCs. Some states have adopted the Uniform Limited Liability Act ("ULLCA"), which was prepared by the National Conference of Commissioners on Uniform State Laws and adopted by the ABA Section of Business Law in 1994. To coordinate with later developments in federal tax guidelines regarding manager-managed LLCs, the National Conference of Commissioners on Uniform State Laws Commissioners adopted minor changes in 1995. *See* UNIF. LTD. LIAB. CO. ACT (as amended 1995), 6A U.L.A. 425 (Supp. 2002). Despite its avowed purpose to promote uniformity and consistency in LLC statutes, it has not been widely accepted or adopted. In fact, only seven jurisdictions (Alabama, Hawaii, South Carolina, South Dakota, Vermont, West Virginia, and the U.S. Virgin Islands) have adopted the ULLCA, although several states (including Illinois) have adopted many of the ULLCA provisions. As one commentator has noted, the ULLCA "has received only a lukewarm reception." Charles W. Murdock, *Limited Liability Companies in the Decade of the 1990s: Legislative and Case Law Developments and Their Implications for the Future*, 56 Bus. Law. 499, 500-03 (2001). *See also* Jennifer J. Johnson, *Limited Liability for Lawyers: General Partners Need Not Apply*, 51 BUS. LAW. 85, n.69 (1995); Carter G. Bishop, *The Uniform Limited Liability Company Act: Summary & Analysis*, 51 BUS. LAW. 51 (1995). In addition to the ULLCA, in 1993 a Prototype Limited Liability Company Act ("Prototype Act") was prepared by the Subcommittee on Limited Liability Companies of the American Bar Association Section of Business Law. The Prototype Act has formed the basis of several LLC statutes that were enacted since its introduction. One commentator has suggested that state legislatures should refer to either the

DLLC Act or the Prototype Act when drafting LLC statutes. *See* Larry B. Ribstein, *A Critique of the Uniform Limited Liability Act: Summary & Analysis*, 25 STETSON L. REV. 311, 329 (1995).

With respect to bankruptcy issues affecting LLCs (which are of great concern to title insurers), it is uncertain whether, in the absence of clear-cut case law, the Code will eventually be amended to specifically define and deal with LLCs. At a 1997 meeting of the National Bankruptcy Review Commission, which considered proposed amendments to the Code, the Small Business, Partnership and Single Asset Real Estate Working Group submitted a Memorandum suggesting that the Code be amended to provide for similar treatment of partners and LLC members under the Code, the exclusion of partnership and LLC agreements from the executory contract provisions of Section 365, and the unenforceability of *ipso facto* clauses. The Memorandum did not suggest altering the overall treatment of debtor LLCs in bankruptcy, but only provided for specific treatment of the LLC relationship for LLC member or LLC manager debtors. The Memorandum stated that LLC members are similar to general partners in member-managed LLCs and similar to limited partners or shareholders in manager-managed LLCs. *See* Sally S. Neely, *Partnerships and Partners and Limited Liability Companies and Members in Bankruptcy: Proposals for Reform*, 71 AM. BANKR. L.J. 271, 311 (1997). No further action has been taken on this proposal and a legislative solution does not appear imminent, as No further action has been taken on this proposal and a legislative solution does not appear imminent, as the revisions to the Code effected by the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, P.L. 109-8 (with an effective date, with certain exceptions, of October 17, 2005, the date that is 180 days after the bill was signed into law on April 20, 2005), did not include any provisions addressing LLC issues.

APPENDIX A

CERTIFICATE OF FORMATION

OF _____ LIMITED LIABILITY COMPANY (DELAWARE)

The undersigned, an authorized natural person for the purpose of forming a limited liability company, under the provisions and subject to the requirements of the State of Delaware (particularly Chapter 18, Title 6 of the Delaware Code and the acts amendatory thereof and supplemental thereto, and known, identified, and referred to as the “Delaware Limited Liability Company Act”), hereby certifies that:

FIRST: The name of the limited liability company (hereinafter called the “limited liability company”) is _____, L.L.C.

SECOND: The address of the registered office and the name and the address of the registered agent of the limited liability company required to be maintained by Section 18-104 of the Delaware Limited Liability Company Act are Lexis Document Services, Inc., 15 East North Street, Dover, Delaware 19901.

Executed on _____, 19____.

Authorized Person

APPENDIX B

**LIMITED LIABILITY COMPANY AGREEMENT (SHORT FORM - DELAWARE)
OF
_____, L.L.C.**

This Limited Liability Company Agreement (this "Agreement") of _____, L.L. C., is entered into between _____ and _____, as members (the "Members").

The Members hereby form a limited liability company pursuant to and in accordance with the Delaware Limited Liability Company Act (6 Del. C. Sec. 18-101, et seq.), as amended from time to time (the "Act"), and hereby agree as follows:

1. Name. The name of the limited liability company formed hereby is _____, L.L.C. (the "Company").
2. Purpose. The Company is formed for the object and purpose of, and the nature of the business to be conducted and promoted by the Company is, engaging in any lawful act or activity for which limited liability companies may be formed under the Act and engaging in any and all activities necessary or incidental to the foregoing.
3. Registered Office. The address of the registered office of the Company in the State of Delaware is c/o Lexis Document Services, Inc., 15 East North Street, Dover, Kent County, Delaware 19901.
4. Registered Agent. The name and address of the registered agent of the Company for service of process on the Company in the State of Delaware is Lexis Document Services, Inc., 15 East North Street, Dover, Kent County, Delaware 19901.
5. Members. The names and the mailing addresses of the Members are as follows:

Name	Address

6. Powers. The business and affairs of the Company shall be managed by the Members. The Members shall have the power to do any and all acts necessary or convenient to or for the furtherance of the purposes described herein, including all powers, statutory or otherwise, possessed by members under the laws of the State of Delaware. _____ is

hereby designated as an authorized person, within the meaning of the Act, to execute, deliver and file the certificate of formation of the Company (and any amendments and/or restatements thereof) and any other certificates (and any amendments and/or restatements thereof) necessary for the Company to qualify to do business in a jurisdiction in which the company may wish to conduct business.

7. Dissolution. The Company shall dissolve, and its affairs shall be wound up upon the first to occur of the following: (a) December 31, 2026, unless continuation of the Company's existence is agreed upon by all of the Members, (b) the written consent of the members, (c) the death, retirement, resignation, expulsion, bankruptcy or dissolution of a Member or the occurrence of any other event which terminates the continued membership of a Member in the Company, unless continuation of the Company's existence is agreed upon by all of the other Members, or (d) the entry of a decree of judicial dissolution under Section 18-802 of the Act.

8. Capital Contributions. The Members have contributed the following amounts, in cash, other property and services, to the Company:

_____	_____
_____	_____

9. Additional Contributions. No Member is required to make any additional capital contribution to the Company.

10. Allocation of Profits and Losses. The Company's profits and losses shall be allocated in proportion to the capital contributions of the Members.

11. Distributions. Distributions shall be made to the Members at the times and in the aggregate amounts determined by the Members. Such distributions shall be allocated among the Members in the same proportion as their then capital account balances.

12. Assignments. A Member may not assign in whole or in part his limited liability company interest without the consent of all the Members. A Member may withhold its approval in its absolute and sole discretion.

13. Resignation. A Member may not resign from the Company.

14. Admission of Additional Members. One(1) or more additional members of the Company may be admitted to the Company with the consent of all of the Members.

15. Liability of Members. The Members shall not have any liability for the obligations or liabilities of the Company except to the extent provided in the Act.

16. Governing Law. This Agreement shall be governed by, and construed under, the laws of the State of Delaware, all rights and remedies being governed by said laws.

IN WITNESS WHEREOF, the undersigned, intending to be legally bound hereby, have duly executed this Limited Liability Company Agreement as of the _____ day of _____, 19____.

APPENDIX C

NON-IMPUTATION ENDORSEMENT (LLC)

Attached to Policy No. _____

Issued By

_____ Title Insurance Company

The Company hereby assures _____ (the "Incoming Member") that in the event of actual monetary loss or damage sustained or incurred by _____ [insert the name of the insured] which is insured against under the terms of the policy, the Company will not deny liability under the policy to the insured on the grounds that the insured had knowledge of any matter solely by reason of notice thereof imputed to it through _____ (the "Outgoing Member") by operation of law.

This endorsement is made a part of the Policy and is subject to all the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the Policy and prior endorsements, if any, nor does it extend the effective date of the Policy and prior endorsements nor does it increase the face amount thereof.

_____ Title Insurance Company

By: _____
Authorized Signatory

APPENDIX D

NON-IMPUTATION ENDORSEMENT (LLC) (ALTERNATIVE)

Attached to Policy No. _____

Issued By

_____ Title Insurance Company

The Company hereby assures the insured that, in the event of actual monetary loss or damage incurred by the insured which is insured against under the terms of the policy, the Company will not deny liability under the policy on the grounds that the insured had knowledge of any matter solely by reason of notice thereof imputed to the insured through _____ (the "Outgoing Member" [or "Outgoing Members"]), but only to the extent of the percentage interest in the insured held by _____ (the "Incoming Member" [or "Incoming Members"]).

This endorsement is made a part of said policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

_____ Title Insurance Company

By: _____
Authorized Signatory

suggest the existence of any unrecorded legal or equitable interests in the Property.

- 7. The Company has sufficient assets, excluding the value of the Property, to satisfy all unrecorded debts, demands or equities created, suffered or permitted by the Company and the transaction pursuant to which the Purchaser acquires the membership interests in the Company will not render the Company insolvent nor is such acquisition by the Purchaser a fraudulent transfer under the bankruptcy laws of the United States or any similar creditors' rights laws.
- 8. The undersigned make this affidavit for the purpose of inducing _____ to include the non-imputation endorsement as described in Paragraph 2 with the knowledge that _____ would not issue such non-imputation endorsement without having first received this affidavit and will rely on the assurances and representations made herein.
- 9. The undersigned acknowledge that they have read the foregoing and fully understand the legal ramifications of any misrepresentations and/or untrue statements made herein and hereby indemnify and hold _____ harmless against any liability occasioned by reason of its reliance on the statements made herein.

Each of the undersigned certify under penalty of perjury that the foregoing is true and correct.

_____ Name	_____ Date	_____ Name	_____ Date
_____ Name	_____ Date	_____ Name	_____ Date
_____ Name	_____ Date	_____ Name	_____ Date
_____ Name	_____ Date	_____ Name	_____ Date

Subscribed and sworn to before me this _____ day of _____, _____.

Notary Public _____

My Commission Expires:

APPENDIX F

FAIRWAY ENDORSEMENT (LLC)

Attached to Policy No. _____

Issued By

_____ Title Insurance Company

The Company hereby assures the insured Limited Liability Company that this Policy and the coverage provided to the insured Limited Liability Company hereunder shall not be deemed to have lapsed, or to have been forfeited, or to have terminated because of the occurrence, subsequent to the Date of Policy, of either of the following events:

- a) the admission, substitution, or withdrawal of any individual or entity as a member in the insured Limited Liability Company, or
- b) a change in any member's interest in capital or profits of, the insured Limited Liability Company, or a managing or non-managing member in, the Insured, where, under the terms of the operating agreement of the Insured (as the same may be amended and restated) the business of the Insured continues after such event.

Nothing contained herein shall be deemed to be a waiver of any rights the Company may otherwise have under this Policy.

This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

_____ Title Insurance Company

By: _____
Authorized Signatory

APPENDIX G

MEZZANINE FINANCING ENDORSEMENT

Attached to Policy No. _____

Issued by

_____ TITLE INSURANCE COMPANY

1. _____ (“Mezzanine Lender”) is hereby added as a loss payee under this policy. The Company acknowledges that Mezzanine Lender has made a loan (the “Mezzanine Loan”) to _____, a _____ real estate investment trust (the “Borrower”). The Borrower is the sole member of _____, LLC (“LLC 1”), a Delaware limited liability company that is the sole member of _____, LLC (“LLC 2”), a Delaware limited liability company that is the sole member of the Insured. To secure the Mezzanine Loan, the Borrower has granted to the Mezzanine Lender a security interest in the Borrower’s membership interest in LLC 1 (the “Security Interest”). In the event of payment by the Company to the Insured for any loss insured against under the terms of the policy, all payments shall be made directly to the Mezzanine Lender. By its execution hereinbelow of this endorsement, the Insured, LLC 1, LLC 2 and Borrower (collectively, “Owners”) each approves of the terms and provisions of this paragraph pertaining to the naming of Mezzanine Lender as a loss payee.

2. In the event of loss or damage from a matter insured against under this policy, the Company shall not deny liability to the Insured on the ground that any or all of the membership interests in the Insured have been transferred to or acquired by Mezzanine Lender directly or indirectly, after the Date of Policy pursuant to the Security Interest.

3. Notwithstanding Section 3(b) of the Exclusions from Coverage of this policy, the Company assures Mezzanine Lender that, unless and until Mezzanine Lender shall have been paid in full, in the event of loss or damage insured against under the terms of the policy, the Company will not deny its liability to Mezzanine Lender on the ground that the defect, lien, encumbrance or other matter creating or causing the loss was known to the Insured if such defect, lien, encumbrance or other matter was not actually known (as opposed to known by imputation by operation of law) to Mezzanine Lender, but which matter was known to any one or more of the Owners or to any owners of interests in Borrower (“Principals”) (whether actually known or known by imputation) at the Date of Policy shown on Schedule A.

All rights of subrogation and indemnity that the Company may have against any Owners shall not be asserted in respect of matters for which Mezzanine Lender is afforded coverage pursuant to the provisions of this paragraph 3, unless and until the Mezzanine Loan shall have been paid in full; the Company’s subrogation rights against the Principals shall not be affected hereby. In the event of loss under this endorsement following acquisition by Mezzanine Lender of some or all of the interests in the Insured, the amount of such loss paid by the Company under this endorsement shall be equal to the actual loss (as determined under the Conditions and Stipulations of the policy) less a percentage of such loss equal to the percentage of membership

interests not owned, directly or indirectly, by Mezzanine Lender at the time such loss is paid. In the event of loss under this endorsement prior to the acquisition by Mezzanine Lender of any direct or indirect interest in the Insured, the amount which the Company shall be liable to pay shall be determined without requiring Mezzanine Lender to pursue its remedies against any collateral which secured the Mezzanine Loan. The liability of the Company under this endorsement shall in no case exceed the diminution in the value of the land caused by the defect, lien, encumbrance or other matter less the liability of the Company under any loan policy of title insurance insuring any deed of trust or mortgage shown in Schedule B of this policy. In no event shall the loss paid to Mezzanine Lender pursuant to the provisions of this paragraph 3 exceed the amount of the Mezzanine Loan.

Subrogation rights of the Company shall include entitlement to reimbursement for all amounts paid under this endorsement should the Mezzanine Loan be repaid or recovered through other security, such possible repayment or recovery being intended to render loss described herein as contingent. Company agrees that it will not exercise its subrogation rights set forth in this paragraph until the Mezzanine Loan shall have been paid in full.

As used in this endorsement Mezzanine Lender means the Mezzanine Lender named hereinabove, and includes the owner of the Mezzanine Loan and each successor in ownership of the Mezzanine Loan (reserving, however, all rights and defenses as to any successor that the Company would have had against Mezzanine Lender and any successor thereto who is a predecessor in interest to the then owner of the Mezzanine Loan, unless the successor making the claim hereunder acquired the Mezzanine Loan as a purchaser for value without knowledge of the asserted defect, lien, encumbrance, adverse claim or other matter insured against by this policy affecting title to the estate or interest in the land). Without limiting the generality of the foregoing, the rights of the Mezzanine Lender under this endorsement shall inure to the benefit of any entity that is owned or controlled by _____, to whom a transfer is made by Mezzanine Lender of the Mezzanine Loan or any interests therein.

The liability of the Company under this policy shall in no case exceed the least of:

(i) the amount of insurance stated in Schedule A, or, if applicable, the amount of insurance as defined in paragraph 2(c) of the conditions and stipulations; or

(ii) the amount of the indebtedness secured by the Mezzanine Loan as determined under paragraph 9 of the conditions and stipulations, at the time the loss or damage insured against hereunder occurs, together with interest thereon; or

(iii) the difference between the value of the insured estate or interest as insured and the value of the insured estate or interest subject to the defect, lien, encumbrance or other matter insured against by this policy.

This endorsement is made part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

Dated:

_____ **TITLE INSURANCE COMPANY**

By: _____
Authorized Signatory

The undersigned join in the execution of this endorsement to evidence their consent to the Mezzanine Lender being named as a loss payee under the policy pursuant to the provisions of paragraph 1 hereof.

_____, LLC.
a Delaware limited liability company

By: _____
Its: _____
Name: _____

LLC 1, LLC.
a Delaware limited liability company

By: _____
Its: _____
Name: _____

LLC 2, LLC.
a Delaware limited liability company

By: _____
Its: _____
Name: _____

APPENDIX H

MEZZANINE FINANCING ENDORSEMENT (ALTERNATIVE)

Attached to Policy No.

Issued by

_____ TITLE INSURANCE COMPANY

1. _____, a _____, as lender and the other lenders, from time to time ("**Mezzanine Lender**"), is hereby added as a loss payee under this policy. The Company acknowledges that Mezzanine Lender has made a loan to _____ (the "**Borrower**" or the "**Insured**") and has been granted a security interest in the Borrower's [**membership/partnership**] interest in the Insured as collateral for such loan (the "Security Interest"). In the event of payment by the Company to the Insured for any loss insured against under the terms of the policy all payments shall be made to the Mezzanine Lender.

2. Notwithstanding anything to the contrary contained in this policy, in the event of loss or damage from a matter insured against by this policy, the Company shall not deny liability to the Insured on the ground that any or all of the [**membership/partnership**] interests in the Insured have been transferred to or acquired by Mezzanine Lender after the Date of Policy pursuant to the terms of that certain Security Interest.

3. Notwithstanding Section 3(b) of the Exclusions from Coverage of this policy, the Company assures Mezzanine Lender that in the event of loss or damage insured against under the terms of the policy, the Company will not deny its liability to Mezzanine Lender on the ground that the defect, lien, encumbrance or other matter creating or causing the loss was known to the Insured if such defect, lien, encumbrance or other matter was not actually known (as opposed to known by imputation by operation of law), to Mezzanine Lender, but which matter was known to any one or more of the other [**members/partners**] of the Insured itself (whether actually known or known by imputation) at the original date of policy shown on Schedule A.

Provided, however, that the Company shall have no liability under this paragraph 3 of this endorsement to any [**member/partner**] of the Insured other than Mezzanine Lender and all rights of subrogation and indemnity that the Company may have against any such other [**member/partner**] of the Insured shall not be affected hereby. In the event of loss under this endorsement following acquisition by Mezzanine Lender of some or all of the interests in the Insured, the amount of such loss paid by the Company under this endorsement shall be equal to the actual loss (as determined under the Conditions and Stipulations of the policy) less a percentage of such loss equal to the percentage of [**membership/partnership**] interests owned by any [**member/partner**] other than Mezzanine Lender at the time such loss is paid. In the event of loss under this endorsement prior to the acquisition by Mezzanine Lender of any interests in the insured, the amount which the Company shall be liable to pay shall be determined without requiring Mezzanine Lender to pursue its remedies against any of its collateral which

secures the indebtedness. The liability of the Company under this endorsement shall in no case exceed the diminution in the value of the property caused by the defect, lien, encumbrance or other matter less the liability of the Company under any loan policy of title insurance insuring any deed of trust or mortgage shown in Schedule B of the policy. In no event shall the loss paid to Mezzanine Lender pursuant to the provisions of this paragraph 3 exceed the amount of indebtedness for which the **[membership/partnership]** interest in the Insured are or was collateral. Provided, however, that nothing in this endorsement shall affect or impair the Company's rights of subrogation with respect to the insured land.

Subrogation rights of the Company shall include entitlement to reimbursement for all amounts paid under this endorsement should the indebtedness secured by the **[membership/partnership]** interests in the Insured be repaid or recovered through other securities, such possible repayment or recovery being intended to render loss described herein as contingent. Company agrees that it will not exercise its subrogation rights set forth in this paragraph until the Mezzanine Lender's indebtedness is paid in full.

As used in this endorsement Mezzanine Lender means the Mezzanine Lender named hereinabove, and includes the owner of the indebtedness secured by the **[membership/partnership]** interests in the Insured, and each successor in ownership of the indebtedness (reserving, however, all rights and defenses as to any successor that the Company would have had against Mezzanine Lender and any successor making the claim hereunder acquired the indebtedness as a purchaser for value without knowledge of the asserted defect, lien, encumbrance, adverse claim or other matter insured against by this policy affecting title to the estate or interest in the land.

This endorsement is made part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsement thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

[Remainder of page intentionally left blank.]

Dated: _____, _____

_____ TITLE INSURANCE COMPANY

By: _____
Authorized Signatory

APPENDIX I

MEZZANINE FINANCING ENDORSEMENT (New York) (Owner's Policy Only)

Attached to Policy No.

Issued by

_____ TITLE INSURANCE COMPANY

Attached to and made part of Policy Number _____

1. Having been directed by the Insured, the Company agrees that any amount payable to the Insured in connection with any claim under this Policy shall be paid to the Mezzanine Lender; as hereafter defined.
 - a. "Mezzanine Lender" means (insert name of Mezzanine Lender), a (insert state of formation of Mezzanine Lender) (insert type of entity), as the owner of the Mezzanine Loan, and each successor in ownership of the Mezzanine Loan (reserving however, all rights and defenses as to any subsequent owner of the Mezzanine Loan unless the successor making the claim hereunder acquired the Mezzanine Loan as a purchaser for value without knowledge of the asserted defect, lien, encumbrances, adverse claim or other matter insured against by this Policy affecting title to the estate or interest in the Land).
 - b. "Mezzanine Loan" means the loan made by Mezzanine Lender to _____ ("Borrower") being member(s) or partner(s) of the Insured, each of whom have pledged their interest in the Insured (the "Pledge") to the Mezzanine Lender to secure the Mezzanine Loan. It is expressly understood that the Company does not insure, and assumes no liability whatsoever as to, the validity, priority, form, sufficiency, or enforceability of the Pledge or any other documents or instruments effectuating the Mezzanine Loan.
 - c. This agreement on behalf of the Company is not to be construed as recognizing or insuring that the Mezzanine Lender has any right, title or interest in the Land.
 - d. This endorsement does not impart any right to the Mezzanine Lender to participate in the negotiation or settlement of any claim under the Policy prior to the acquisition by Mezzanine Lender of some or all of the Borrower's interests (direct or indirect) in the Insured.
 - e. This endorsement does not waive any defense which the Company may have against the Insured.
2. In the event of a loss under the Policy prior to the acquisition by Mezzanine Lender of some or all of the Borrower's interest (direct or indirect) in the Insured, the Insured

- assigns (and by signing below hereby confirms said assignment) its right to payment for any loss insured against under the terms of the Policy to Mezzanine Lender, provided that the sums paid to Mezzanine Lender prior to the acquisition shall not, in the aggregate, exceed the outstanding principal balance of the Mezzanine Loan (including any accrued interest, fees, costs, and protective advances thereunder) as of the date of the said loss. Any payment made to the Mezzanine Lender pursuant to this paragraph shall reduce the amount of insurance under the Policy by the sum paid.
3. In the event of a loss under the Policy following the acquisition, pursuant to the Pledge, by Mezzanine Lender of some or all of the Borrower's interests (direct or indirect) in the Insured the amount of the loss paid by the Company under the Policy shall be equal to the actual loss (as determined under the Conditions and Stipulations of the Policy) multiplied by the percentage interest in the Insured, at the time the loss is paid, that has been acquired, directly or indirectly, by the Mezzanine Lender pursuant to the Pledge.
 4. In the event of a loss under the Policy, the Company shall not deny liability to the Insured on the ground that any or all of the partnership/limited liability company interests in the Insured have been transferred to or acquired, pursuant to the Pledge, by the Mezzanine Lender, directly or indirectly, subsequent to Date of Policy. Nothing contained herein shall be construed as extending the insurance hereunder as to matters attaching or created subsequent to the date hereof or insuring the status of the insured after the transfer of the partnership/limited liability company interests, the withdrawal of partners/members, or the addition of new partners/members.
 5. In the event that the Mezzanine Loan is repaid or recovered in full, the Company shall be subrogated to and be entitled to all rights and remedies which the Mezzanine Lender has or would have had against any person or property, other than the Land insured herein, to the extent of all payments made to Mezzanine Lender pursuant to this endorsement.
 6. In the event that both the Insured and the Mezzanine lender claim entitlement to all or part of the loss payable under the Policy, the Company may interplead the amount of the loss into Court, and the Insured and the Mezzanine Lender shall be jointly and severally liable to the Company for the cost of such interpleader and subsequent proceedings incurred by the Company, including legal fees. The company shall be entitled to payment of the sums for which the Insured and Mezzanine Lender liable under this paragraph from the funds deposited into Court, and the Company may make application to the Court therefor.
 7. The Mezzanine Lender acknowledges Section 11 of the Conditions and Stipulations of the Policy ("Liability Noncumulative"), and further acknowledges that the Company shall have the right to insure mortgages or other conveyances of the interest in the Land, without the consent of the Mezzanine Lender.

This endorsement is made a part of the Policy and is subject to all of the terms and provision thereof and of any other endorsement thereto. Except to the extent expressly stated, it neither

modifies any of the terms and provisions of the Policy and any other endorsements, nor does it extend the effective date of the Policy and any other endorsements, nor does it increase the face amount thereof.

Dated:

Countersigned (Insured)

_____ Title Insurance Company

By: _____

By: _____

APPENDIX J

MEZZANINE FINANCING ENDORSEMENT (ALTA)

American Land Title Association

Endorsement 16 (Mezzanine Financing)

Adopted 10/22/04

Section IV-29

ENDORSEMENT
Attached to Policy No.

Issued by
BLANK TITLE INSURANCE COMPANY

1. The Mezzanine Lender is:
and each successor in ownership of its loan (“Mezzanine Loan”) reserving, however, all rights and defenses as to any successor that the Company would have had against the Mezzanine Lender, unless the successor acquired the indebtedness as a purchaser for value without knowledge of the asserted defect, lien, encumbrance, adverse claim or other matter insured against by this policy as affecting title to the estate or interest in the land.
2. The insured:
 - (a) assigns to the Mezzanine Lender the right to receive amounts otherwise payable to the insured under this policy, not to exceed the outstanding indebtedness under the Mezzanine Loan; and
 - (b) agrees that no amendment of or endorsement to this policy can be made without the written consent of the Mezzanine Lender except as provided in Section 12(a) of the Conditions and Stipulations.
3. The Company does not waive any defenses that it may have against the insured, except as expressly stated in this endorsement.
4. In the event of a loss under the policy, the Company agrees that it will not assert the provisions of Exclusions from Coverage 3(a), (b) or (e) to refuse payment to the Mezzanine Lender solely by reason of the action or inaction or knowledge, as of Date of Policy, of the insured, provided:
 - (a) the Mezzanine Lender had no knowledge of the defect, lien, encumbrance or other matter creating or causing loss on Date of Policy.
 - (b) this limitation on the application of Exclusions from Coverage 3(a), (b) and (e) shall:
 - (1) apply whether or not the Mezzanine Lender has acquired an interest (direct or indirect) in the insured either on or after Date of Policy, and
 - (2) benefit the Mezzanine Lender only without benefiting any other individual or entity that holds an interest (direct or indirect) in the insured or the land.

5. In the event of a loss under the Policy, the Company also agrees that it will not deny liability to the Mezzanine Lender on the ground that any or all of the ownership interests (direct or indirect) in the insured have been transferred to or acquired by the Mezzanine Lender, either on or after the Date of Policy.
6. The Mezzanine Lender acknowledges:
 - (a) that the amount of insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B or to which the insured has agreed, assumed, or taken subject, or which is hereafter executed by an insured and which is a charge or lien on the estate or interest described or referred to in Schedule A, and the amount so paid shall be deemed a payment under this policy; and
 - (b) that the Company shall have the right to insure mortgages or other conveyances of an interest in the land, without the consent of the Mezzanine Lender.
7. If the insured, the Mezzanine Lender or others have conflicting claims to all or part of the loss payable under the Policy, the Company may interplead the amount of the loss into Court. The insured and the Mezzanine Lender shall be jointly and severally liable for the Company's reasonable cost for the interpleader and subsequent proceedings, including attorneys' fees. The Company shall be entitled to payment of the sums for which the insured and Mezzanine Lender are liable under the preceding sentence from the funds deposited into Court, and it may apply to the Court for their payment.
8. Whenever the Company has settled a claim and paid the Mezzanine Lender pursuant to this endorsement, the Company shall be subrogated and entitled to all rights and remedies that the Mezzanine Lender may have against any person or property arising from the Mezzanine Loan. However, the Company agrees with the Mezzanine Lender that it shall only exercise these rights, or any right of the Company to indemnification, against the insured, the Mezzanine Loan borrower, or any guarantors of the Mezzanine Loan after the Mezzanine Lender has recovered its principal, interest, and costs of collection. If a payment on account of a claim does not fully cover the loss of the insured claimant, the Company shall be subrogated to all rights and remedies of the insured claimant after the insured claimant shall have recovered its principal, interest, and costs of collection.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

AGREED AND CONSENTED TO:

(Insert name of Insured)

(Insert name of Mezzanine Lender)

By: _____

By: _____

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY:

APPENDIX K

**FIRST AMENDMENT TO
THE OPERATING AGREEMENT FOR [NAME OF LLC ISSUER]**

The undersigned, being all of the Members of [NAME OF LLC ISSUER], a [STATE OF ORGANIZATION] limited liability company (the “Company”), hereby agree that a new Section [] is added to the Operating Agreement of the Company dated as of [], 200[], reading in its entirety as follows:

Section []. Units Deemed to be Securities.

Pursuant to [APPLICABLE] Code [REFERENCE TO APPLICABLE STATE UNIFORM COMMERCIAL CODE § 8103(C)], the Units of Company capital held by Members of the Company shall be considered to be securities governed by [ARTICLE 8 STATE REFERENCE] of the [APPLICABLE] Code.

This First Amendment to the Operating Agreement for [NAME OF LLC ISSUER] may be executed by the parties hereto by means of facsimile signatures and in multiple counterparts, each of which shall be deemed an original and all of which, taken together, shall constitute one and the same instrument.

EXECUTED AND EFFECTIVE as of the _____ day of _____, 200[]

[MEMBERS]

By: _____

[MEMBERS]

By: _____

APPENDIX L

Issuer’s Acknowledgment and Consent

To: [Proposed Insured]

Reference is made to that certain [Pledge and Security Agreement] dated as of [], 200[] (as amended, supplemented or otherwise modified from time to time, the “Pledge Agreement”), between [] (the “Mezzanine Lender”) and [], a [] limited liability company, (the “Pledgor”) and this acknowledgement relates to those membership interests (the “Pledged interests”), as further described on Schedule I to the Pledge Agreement.

[], the issuer of the Pledged Interests, acknowledges and agrees that the pledged interests are investment property subject to the provisions of Article 8 of the [applicable State] Uniform Commercial Code.

Dated: [], 200[]

Very truly yours,

ISSUER:

By: _____

Name:

Title:

ACKNOWLEDGED AND AGREED:

PLEDGOR:

By: _____

Name:

Title:

APPENDIX M

CONTROL AGREEMENT

This Control Agreement (“Agreement”) is made and entered into as of the ____ day of [] 200[], by and among [Name of Borrower], a [] corporation, (“Borrower”), [Name of Insured], a [] corporation (“Lender”), and [Name of pledging Debtor] (the “Pledgor”).
[Assumes that the Borrower is the issuer of the Pledged Collateral]

RECITALS:

WHEREAS, Lender has agreed to loan the aggregate sum of [] Million Dollars (\$[],000,000.00) (the “Loan”) to Borrower, pursuant to a Secured Promissory Note of even date herewith in such original principal amount, executed by Borrower in favor of Lender (the “Note”)’ and a Loan Agreement of even date herewith between Borrower and Lender (the “Loan Agreement”); and

WHEREAS, the Pledgor has guaranteed the indebtedness of Borrower to Lender evidenced by the Note pursuant to a General Continuing Guaranty of even date executed by Pledgor in favor of Lender (the “Guaranty”); and

WHEREAS, the obligations of the Pledgor to the Lender under the Guaranty are secured, in part, by a pledge to Lender of Pledgor’s []% membership interest in Borrower (such interest being referred to herein as the (“Pledged Collateral”) pursuant to a Pledge and Security Agreement of even date herewith, executed by Pledgor in favor of Lender (the “Pledge Agreement”); and

WHEREAS, the parties hereto wish to acknowledge such security interest and pledge and Lender’s control over the Pledged Collateral for purposes of the provisions of Article 8 and Article 9 of the Uniform Commercial Code as enacted and in effect in the State of [] (the “UCC”).

AGREEMENT:

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Defined Terms. All capitalized terms used but not otherwise defined herein shall have the respective meanings ascribed thereto in the Loan Agreement.

2. Acknowledgment of Security Interest. Borrower hereby acknowledges and agrees that, pursuant to the Pledge Agreement, Lender has been granted and continues to hold a security interest in and to the Pledged Collateral as collateral security for the obligations of Pledgor under the Guaranty.

3. Agreement to Follow Instructions; Agreement Not to Register Transfer. Borrower, as issuer of the Pledged Collateral, hereby agrees to comply with any “instructions” (as defined in Section 8102(a)(12) of the UCC) originated by Lender without further consent of the Pledgor, including, without limitation, instructions regarding the transfer, redemption or other disposition of the Pledged Collateral or the proceeds thereof, including any distributions with respect

thereto. Pledgor agrees that it shall not register any transfer of the Pledged Collateral to any person without the prior written consent of Lender.

4. Intent of the Parties. By executing and delivering this Agreement, the parties hereto intend to establish Lender's control over the Pledged Collateral for purposes of the provisions of Section 8106(c)(2) of the UCC.

5. Consent. Pledgor hereby consents to the execution and delivery of this Agreement by Borrower and Lender.

6. Choice of Law. This Agreement shall be construed and enforced under the laws of the State of [] without regard to the conflict of law principles thereof

7. Counterparts. This Agreement may be executed in any number of separate counterparts, each of which shall collectively and separately constitute one agreement.

8. Amendments. No amendment, waiver, termination or other modification to this Agreement shall be effective unless the same is in writing and is signed by each of the parties hereto.

[signature page follows]

IN WITNESS WHEREOF, the parties hereto have executed and delivered this Agreement as of the date first written above.

[BORROWER]

By: _____

Printed: _____

Title:

[INSURED]

By: _____

Printed: _____

Title:

[DEBTOR]

By: _____

Printed:

Title:

APPENDIX N

MEZZANINE FINANCING ENDORSEMENT (ALTERNATIVE) (UCC)

ATTACHED TO EAGLE 9™ UCC INSURANCE POLICY NO.

ISSUED BY

FIRST AMERICAN TITLE INSURANCE COMPANY

The Company hereby confirms that the Certificates (the “Certificates”) representing the membership interests in ABC LLC, a _____ limited liability company, as described in the Mezzanine Loan Agreement dated as of _____, 2001 among DEF LLC, a _____ limited liability company, as Mezzanine Borrower, and XYZ BANK, NATIONAL ASSOCIATION, a national banking association, as Mezzanine Lender, is included within the Collateral that is covered by this policy.

The following Exclusions from Coverage do not apply to the Certificates:

- (a) Exclusion 1(a);
- (b) Exclusion 3(b);
- (c) Exclusion 4(b) and
- (d) Exclusion 5(h)

This endorsement does not insure against, and the Company will not pay loss or damage, costs, legal fees or expenses that arise by reason of any adverse claim affecting the Certificates not Known to the Company, but of which the Insured has Notice.

This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

FIRST AMERICAN TITLE INSURANCE COMPANY

BY: _____
AUTHORIZED SIGNATORY

EAGLE 9™ UCC Insurance Policy (3/01 Version) - Mezzanine Loan Endorsement
(Certificates Representing Membership Interests — “Opting In” to Article 8 of the
UCC)
(5-7-01)

APPENDIX O

Single-Member Limited Liability Company Operating Agreement (Illinois)

YYYY
Operating Agreement

This Operating Agreement (said agreement as amended from time to time shall be referred to herein as the “Agreement”) is entered into this _____ day of _____ by _____ (“XXXX”).

Explanatory Statement

XXXX desires to organize and operate a limited liability company in accordance with the terms oil and subject to the conditions set forth in, this Agreement.

NOW, THEREFORE, for good and valuable consideration, XXXX, intending legally to be bound, agrees as follows:

**Section I
Defined Terms**

In addition to any terms that are defined in the text of this Agreement, capitalized terms shall have the meanings ascribed to them in Exhibit B of this Agreement.

**Section II
Formation and Name; Office; Purpose; Term**

XXXX hereby agrees to organize a limited liability company pursuant to the Act and the provisions of this Agreement and, for that purpose, has caused or, or on or prior to _____ shall cause Articles of Organization to be prepared, executed and filed with the Secretary. The name of the Company shall be YYYY. The Company may do business under that name and under any other name or names upon which a Majority-in-Interest of the Members [the Manager shall] determine. Company is organized (a) to _____ (b) to do any and all things necessary, convenient or incidental to that purpose and (c) for any other lawful purpose for which LLCs may be organized under the Act. The term of the Company began or shall begin upon the filing of the Articles of Organization by the Secretary and shall continue in perpetual existence until dissolved pursuant to this Agreement. The registered office of the Company in the State of Illinois shall be located at _____, Illinois or at any other place within the State of Illinois that a Majority-in-Interest of the Members [the Manager] may determine. The principal office and place of business of the Company shall be located at _____ or at such other place as a Majority-in-Interest of the Members [the Manager] may designate from time to time. The name and address of the Company’s registered agent in the State of Illinois shall be _____, _____. The name, present mailing address, taxpayer identification number and Percentage of each Member are set

forth on **Exhibit A**. The Members [Manager] shall amend **Exhibit A** from time to time to reflect changes in the identity of the Members and changes in information set forth on **Exhibit A**. This Agreement is the operating agreement of the Company within the meaning of the Act.

Section III Capital

Upon the execution of this Agreement, XXXX shall contribute to the Company the cash and property set forth on **Exhibit A**. XXXX's initial Percentage shall be 100%. [From time to time the Members may, but shall not be obligated to, contribute additional capital or make loans to, the Company, all at such times and upon such terms as a Majority-in-Interest of the Members [the Manager] shall approve, acting in their sole discretion.] No Member shall be required to contribute any additional capital to the Company and no Member shall have any personal liability for any obligations of the Company.

Section IV Profit Loss and Distributions

Cash Flow for each taxable year of the Company shall be distributed to the Interest Holders at such time as determined by a Majority-in-Interest of the Members [Manager], but in any event not later than seventy-five (75) days after the end of the taxable year of the Company in proportion to the Interest Holders' respective Percentage. All Profit or Loss shall be allocated to the Interest Holders in proportion to their respective Percentage. If the Company is dissolved, the assets of the Company shall be distributed as provided in Article VII.

Section V Management: Rights, Powers, and Duties

The Company shall be managed and all decisions regarding the Company shall be made by [a Majority-in-Interest of the Members][the Manager][and, if and to the extent authorized by a Majority-in-Interest of the Members/Manager, an Officer]. [Any Manager or Officer authorized and appointed to act by a Majority-in-Interest of the Members/Manager shall have full power and authority to act for and bind the Company for the purposes so authorized or appointed and third parties may rely upon such authorization or appointment.] [The Manager may be appointed and removed with the approval of a Majority-in-Interest of the Members.] No Member has the authority to act as agent [,Manager or Officer] for the Company unless expressly authorized to so act. The Members shall not be liable, responsible, or accountable to the Company for any act performed by any of them with respect to Company matters, except for their own fraud against the Company. [No Manager or Officer shall be liable, responsible, or accountable to the Company for any act performed by any of them with respect to Company affairs, except for their own fraud, gross negligence or willful misconduct.] The Company shall indemnify Members [,Manager and Officers] for any act performed by any of them with respect to Company matters provided, however, no Member shall be indemnified as a consequence of its own fraud against the Company [and no Manager or Member shall be indemnified as a consequence of such Person's own fraud, gross negligence or willful misconduct against the Company]. [Each Member/Manager/Officer shall be entitled to engage in other businesses and investments even if such business or investment competes with the businesses and investments of the Company and

none of such businesses or investments need be offered to the Company or to the Members in the Company as a Company-opportunity.]

Section VI Transfer and Disassociation

Except as otherwise expressly permitted by this Agreement, no Member shall have the right, without the consent of all other Members, to Transfer all or any part of such Member's Membership Rights. Permitted transferees shall be admitted as Members in the Company if the instrument of transfer specifies that such Transfer includes a transfer of Membership Rights and the transferee agrees in writing to be bound by the terms and conditions of this Agreement, but, if the Transfer is a transfer by operation of law by reason of the death of an individual Person, the dissolution of a non-individual Person or otherwise, and if the result of such Transfer would be the Dissociation of the last remaining Member in the Company, then, the transferee(s) will be automatically admitted as Member(s) in the Company (it being agreed that in the case of death of an individual Person, the estate of such Person shall automatically be admitted as a Member, subject to the remainder of this Section VI) and no instrument of transfer will be required provided, however, any of such transferee(s) may elect, at any time on or before ninety (90) days after such Transfer to them, to engage in Dissociation as a Member in the Company, such Dissociation to be effective retroactive to the date of such Transfer. Dissociation is not prohibited by this Agreement. The Company shall not be obligated to purchase the Interest of any Person who shall be the subject of, or has engaged in, any Dissociation. Notwithstanding any provision contained in this Agreement to the contrary, _____ the initial Member in the Company shall have the right, without the consent of any other Members, to Transfer all or any part of such initial Member's Membership Rights, and such transferees shall, if the instrument of Transfer so specifies, be admitted as a Member in the Company. [For purposes of this Agreement, a Transfer of Interests and other Membership Rights shall include any Transfer of any direct or indirect ownership interests in a Member and any change in the power of a Person to direct the business and affairs of the Member by virtue of ownership of voting securities, contract or otherwise*]. [The Interests and other Membership Rights are securities governed by Article 8 of the Uniform Commercial Code as in effect in the State of Illinois. Interests and Membership Rights shall [not] be certificated. The transferee of a Transfer for collateral purposes shall not be admitted as a Member in the Company until such time, if any, as the transferee has realized upon the Membership Rights pledged to it or has acquired such Membership Rights in lieu of such realization and such transferee expressly agrees in writing to be bound to the terms and conditions of this Agreement].

*(Consider exceptions for affiliate transfers and public company stock transfers)

Section VII Dissolution

The Company shall be dissolved only if all of the Members unanimously determine to dissolve the Company or if the Company has no Members and no Interest Holder agrees in writing, within thirty (30) days after the occurrence of the event pursuant to which the last Person ceased to be a Member, to become a Member and be bound by the terms and conditions

of this Agreement. If the Company is dissolved, the affairs of the Company shall be wound up. On winding up of the Company, the assets of the Company shall be distributed, first, to creditors of the Company in satisfaction of the liabilities of the Company and then to the Interest Holders in the Company in proportion to their Percentage.

Section VIII Books, Accounting, and Tax Matters Member

All funds of the Company shall be deposited in such bank or other investment accounts as the Majority-in-Interest of the Members [Manager] shall approve. All such accounts shall be in the Company's name. The annual accounting period of the Company shall be the calendar year. XXXX shall be the tax matters member unless the Majority-in-Interest of the Members select a different tax matters member, to the extent a tax matters member is required or permitted by applicable law.

Section IX General Provisions

Any notice, demand, consent, election, offer, approval, request, or other communication (collectively, a "notice") required or permitted under this Agreement must be in writing and either delivered personally or sent by certified or registered mail, postage prepaid, return receipt requested. A notice must be addressed to an Interest Holder [,Manager] or Member at the Interest Holder's or Member's last known address on the records of the Company. A notice to the Company must be addressed to the Company's principal office. Notices shall be deemed given upon receipt or refusal to accept delivery. Any party may designate, by notice to all of the others, substitute addresses or addressees for notices; and, thereafter, notices are to be directed to those substitute addresses or addressees. This Agreement constitutes the complete and exclusive statement of the agreement among the Members and supersedes all prior written and oral statements and agreements, including any prior representation, statement, condition, agreement, covenant, or warranty. This Agreement may not be amended without the written consent of a Majority-in-Interest of the Members and all such amendments must be in writing. This Agreement shall be governed by the internal law, not the law of conflicts, of the State of Illinois. The headings herein are inserted as a matter of convenience only, and do not define, limit, or describe the scope of this Agreement or the intent of the provisions hereof. This Agreement is binding upon, and inures to the benefit of, the parties hereto and their respective heirs, executors, administrators, personal and legal representatives, successors and permitted assigns. Common nouns and pronouns shall be deemed to refer to the masculine, feminine, neuter, singular and plural, as the identity of the Person may in the context require. Each provision of this Agreement shall be considered separable; and if, for any reason, any provision or provisions herein are determined to be invalid and contrary to any existing or future law, such invalidity shall not impair the operation of or affect those portions of this Agreement that are valid.

IN WITNESS WHEREOF, the parties have executed, or caused this Agreement to be executed, under seal, as of the date set forth hereinabove.

MEMBER:

[XXXX], a

By:
Name:
Title:

EXHIBIT A

TO OPERATING AGREEMENT

NAME, ADDRESS, TAXPAYER IDENTIFICATION NUMBER
AND CAPITAL CONTRIBUTION

Address and Taxpayer
Identification Number

Percentage

Capital Contribution

XXXX

100%

[Description of property and
amount of cash]

[Address]

[Taxpayer Identification Number]

EXHIBIT B
TO OPERATING AGREEMENT

DEFINITIONS

For purposes of this Agreement, the following terms shall have the meanings set forth below (such meanings to be equally applicable to both the singular and plural forms of the terms so defined).

“Act” means the Illinois Limited Liability Company Act, as amended from time to time.

“Cash Flow” means the revenues and other cash receipts of the Company minus the expenditures of the Company. Cash Flow will not include reserves established by the Company from time to time except to the extent released from the reserves in question for distribution.

“Code” means the Internal Revenue Code of 1986, as amended, or any corresponding provision of any succeeding law.

“Company” means the limited liability company organized in accordance with this Agreement.

“Dissociation” means a Member’s dissociation from the Company by any means.

“Interest” means a Person’s share of the Profits and Losses of, and the right to receive distributions from, the Company.

“Interest Holder” means any Person who holds an Interest, whether as a Member or as an unadmitted assignee of a Member.

[“Manager means any Person from time to time authorized or appointed by a Majority-in-Interest of the Members, on a general basis or for a specific purpose, which Person shall have the power and authority of a manager under the Act for the purpose appointed and as authorized or approved by a Majority-in-Interest of the Members. The initial Manager shall be _____.]

“Majority-Interest-of the Members” means the Members holding a majority of the Percentage held by Members.

“Member” means each Person signing this Agreement and any Person who subsequently is admitted as a member in the Company.

“Membership Rights” means all of the rights of a Member in the Company, including a Member’s: (i) Interest; (ii) right to inspect the Company’s books and records; (iii) right to participate in the management of and vote on matters coming before the Company; and (iv) unless this Agreement or the Articles of Organization provide to the contrary, right to act as an agent of the Company.

[“Officer” means any individual from time to time authorized or appointed by a Majority-in-Interest of the Members/Manager to act as an officer or representative of the Company on a general basis or for a specific purpose, which individual shall act for and bind the Company as authorized by a Majority-in-Interest of the Members/Manager.]

“Percentage” means a Person’s share of Profits, Losses and rights to distributions expressed as a percentage, whether as a Member or unadmitted Interest Holder.

“Person” means and includes an individual, corporation, partnership, association, limited liability company, trust, estate or other entity.

“Profit” and “Loss” means, for each taxable year of the Company (or other period for which Profit or Loss must be computed) the Company’s taxable income or loss determined in accordance with the Code.

“Secretary” means the Illinois Secretary of State.

“Transfer” means, when used as a noun, any direct or indirect sale, hypothecation, pledge, assignment, attachment, or other transfer, and, when used as a verb, means to, directly or indirectly, sell, hypothecate, pledge, assign, or otherwise transfer.