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## THE 2010 AMENDMENTS TO KENTUCKY'S BUSINESS ENTITY LAWS

Thomas E. Rutledge\*

The 2010 General Assembly adopted a number of amendments, most of which are technical, to Kentucky's business entity laws. This series of amendments is less systematic and narrower in scope than the across-the-board amendments adopted by the 2007 General Assembly.<sup>1</sup> Still, a series of amendments were adopted across the business entity laws in response to and for the purpose of legislatively overriding portions of the Kentucky Court of Appeal's ruling in *Barone v. Perkins*.

### I. LEGISLATIVE HISTORY

Senator Tom Jensen introduced Senate Bill ("S.B.") 150, containing the 2010 amendments to the Kentucky business entity laws, on February 8, 2010. The bill was assigned to the Judiciary Committee on February 10.<sup>2</sup> The Judiciary Committee held a hearing on the proposal on February 11,<sup>3</sup> and the bill was passed out of Committee on a vote of ten yays and one nay. S.B. 150 was unanimously voted out of the Senate on February 24,<sup>4</sup> and came before the House Judiciary Committee on March 10.<sup>5</sup> After adoption of the L3C study amendment,<sup>6</sup> the bill was voted out of House Committee by a unanimous vote. The bill came before the House on March 24,<sup>7</sup> where it passed by a vote of

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1. See generally Thomas E. Rutledge, *The 2007 Amendments to the Kentucky Business Entity Statutes*, 97 KY. L.J. 229 (2008-09).

2. <http://www.lrc.ky.gov/record/10RS/SB150.htm>; Senator Jensen also sponsored S.B. 151, which contains the Kentucky Business Entity Filing Act. That act is reviewed in Thomas E. Rutledge and Laura K. Tzanetos, *The Kentucky Business Entity Filing Act: The Next Step Forward in the Rationalization of Business Entity Law*, 38 N. KY. L. REV. 423 (2011).

3. <http://www.lrc.ky.gov/record/10RS/SB150.htm>

4. *Id.*

5. *Id.*

6. See *infra* notes 279 through 281 and accompanying text.

7. <http://www.lrc.ky.gov/record/10RS/SB150.htm>. A proposed floor amendment to the Kentucky Uniform Limited Partnership Act ("KyULPA") and the Kentucky Revised Uniform Limited Partnership Act ("KyRULPA") would have permitted a limited partner to withdraw from the limited partnership and receive a "pro rata distribution" of its assets upon a variety of bases including the limited partner's belief of fraud in the operation of the limited partnership. In effect, limited partnerships would have lost capital lock-in. The floor amendment was withdrawn on

ninety-six yays and two nays.<sup>8</sup> On March 29, 2010, the Senate agreed to certain technical corrections made in the House, and unanimously voted in favor of the bill.<sup>9</sup> The amendments (the "2010 Amendments") set forth in S.B. 150 took effect on July 15, 2010.<sup>10</sup> The amendments are discussed below.

## II. THE RESPONSE TO *BARONE V. PERKINS*

The decision rendered by the Kentucky Court of Appeals in *Barone v. Perkins*,<sup>11</sup> as it touches upon business entity law and specifically the rule of limited liability, may well and likely is dicta; that said, it is dangerous dicta and has for that reason been expressly overruled.

The facts of the *Barone v. Perkins* decision are relatively straightforward. Frank and Christine Barone retained Glen Perkins Custom Homes, LLC ("Perkins LLC") to build a personal residence.<sup>12</sup> Glen Perkins built the home, but after closing the Barone's became dissatisfied with the home's workmanship and construction.<sup>13</sup> In response, they sued Glen Perkins and Edward Hacker, the other member of Perkins, LLC, asserting claims in tort, breach of contract, and violation of applicable building codes.<sup>14</sup> The defendants moved for summary judgment shortly after filing their answer.<sup>15</sup> Defendants supported their motion by affidavits asserting that, *inter alia*, neither of the named defendants had been involved with the various alleged deficiencies in the home and that they could not, as a matter of law, be held liable for those alleged deficiencies.<sup>16</sup> The plaintiffs objected to the motion for summary judgment, noting that no discovery had yet taken place. However, they submitted no affidavits or affirmative evidence in opposition to the defendants' motions for summary judgment.<sup>17</sup> The court granted summary judgment, holding that based upon the affidavits submitted, neither defendant had been involved in the alleged tortious conduct and therefore could not be personally liable.<sup>18</sup> The plaintiff appealed.<sup>19</sup>

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March 23, 2010 in the face of written objections from this author, Turney Berry and Professor Daniel S. Kleinberger, reporter for the Uniform Limited Partnership Act (2001).

8. <http://www.lrc.ky.gov/record/10RS/SB150.htm>.

9. *Id.*

10. See KY. OP. ATT'Y GEN. 10-002 (2010).

11. No. 2007-CA-000838-MR (June 20, 2008), available at 2008 WL 2468792, discretionary review denied January 14, 2009 (2008-SC-0515D).

12. *Id.* at \*1.

13. *Id.*

14. *Id.* The decision notes, but does not explain why, neither the LLC nor the various subcontractors involved in the complained-of work were not named as parties in the action. It is noted that, at the time the suit was filed, the LLC was not in good standing with the Secretary of State, but that during the pendency of the action it was reinstated to good standing.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* at \*2.

19. *Id.* at \*3.

The Court of Appeals upheld the grant of summary judgment, holding that it was not premature.<sup>20</sup> Rather, citing the standard of summary judgment under *Lewis v. B&R Corporation*<sup>21</sup> and *Steelvest, Inc. v. Scansteel Service Center, Inc.*,<sup>22</sup> the Court of Appeals held that there were no combination of facts on which the plaintiffs could prevail.<sup>23</sup>

Had the court stopped at this point, it would have been unnecessary to modify Kentucky's various business organization acts, and *Barone v. Perkins* would be yet another minor skirmish in the continuing war over the appropriate standard for summary judgment. The court, however, continued with its analysis and substantively considered the scope and limits of the liability shield afforded by the LLC Act.<sup>24</sup> Referencing that Act, the court held that because the defendants were at all times acting as members, not employees, of the company, and because neither had committed an individual tort,<sup>25</sup> they were immune from liability for the actions they had undertaken on behalf of the LLC.<sup>26</sup> In the course of this discussion, the Court of Appeals contrasted the LLC Act with the Kentucky Business Corporation Act ("KyBCA"), noting that the latter includes an express statutory recognition that a shareholder otherwise enjoying limited liability may be personally liable "by reason of his own acts or misconduct."<sup>27</sup> Relying upon the LLC Act's lack of an equivalent statutory provision, the Court differentiated the liability shields provided by the two statutes holding, *inter*

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20. *Id.* at \*4.

21. 56 S.W.3d 432, 436 (Ky. App. 2001).

22. 807 S.W.2d 476, 480 (Ky. 1991).

23. *Barone*, 2008 WL 2468792 at \*3.

24. *Id.* at \*4. See also KY. REV. STAT. ANN. § 275.150(1):

Except as provided in subsection (2) of this section or as otherwise specifically set forth in other sections in this chapter, no member, manager, employee, or agent of a limited liability company, including a professional limited liability company, shall be personally liable by reason of being a member, manager, employee, or agent of the limited liability company, under a judgment, decree, or order of a court, agency, or tribunal of any type, or in any other manner, in this or any other state, or on any other basis, for a debt, obligation, or liability of the limited liability company, whether arising in contract, tort, or otherwise. The status of a person as a member, manager, employee, or agent of a limited liability company, including a professional limited liability company, shall not subject the person to personal liability for the acts or omissions, including any negligence, wrongful act, or actionable misconduct, of any other member, manager, agent, or employee of the limited liability company.

25. This conclusion was based upon the affidavits submitted by the Defendants.

26. *Barone*, 2008 WL 2468792 at \*4.

27. *Id.* See also KY. REV. STAT. ANN. § 271B.6-220(2). This provision of the Kentucky Business Corporation Act is a verbatim adoption of Section 6.22(2) of the Model Business Corporation Act, which provides:

Unless otherwise provided in the articles of incorporation, a shareholder of a corporation shall not be personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct.

*alia*, that the liability shield provided by the LLC Act is more robust than that provided by the KyBCA.<sup>28</sup>

This differentiation does not stand up to scrutiny. Section 6.22(2) of the Model Business Corporation Act is a recitation of generally applicable agency law, which states that an agent, in the discharge of responsibilities on behalf of a principal, is always personally liable for his or her own tortious conduct.<sup>29</sup> While it is true that the Court of Appeals, in reliance upon the trial court's finding of fact, noted that the defendants had not personally engaged in any tortious conduct,<sup>30</sup> the differentiation between the statutes as to the presence or absence of language addressing liability for one's "own acts or conduct" must relate to liability arising in tort;<sup>31</sup> assuming the corporation is properly disclosed as the principal, the agent will not be held liable on a contract entered into by the agent on behalf of the principal.<sup>32</sup> This effort to distinguish between the LLC and Business Corporation Acts is especially troubling because the LLC Act expressly incorporates "the principles of law and equity,"<sup>33</sup> which includes the law of agency.

Also curious is the effort by the Court of Appeals to characterize defendants Perkins and Hacker, the members of the LLC, as "members" versus "employees."<sup>34</sup> In almost every circumstance, LLC members will be characterized as members by default because it will be impossible to characterize

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28. *Barone*, 2008 WL 2468792 at \*4.

29. As set forth in the RESTATEMENT (THIRD) OF THE LAW OF AGENCY § 7.01 (2006):

An agent is subject to liability to a third party harmed by the agent's tortious conduct. Unless an applicable statute provides otherwise, an actor remains subject to liability although the actor acts as an agent or an employee, with actual or implied authority, or within the scope of employment.

As set forth in Comment b to the RESTATEMENT (THIRD) OF AGENCY § 7.01:

The justification for this basic rule is that a person is responsible for the legal consequences of torts committed by that person. A tort committed by an agent constitutes a wrong to the tort's victim independently of the capacity in which the agent committed the tort. The injury suffered by the victim of a tort is regardless of whether the tortfeasor acted independently or happened to be acting as an agent or employee of another person.

See also *Brewer Machine & Conveyor Mfg. Co., Inc. v. Old National Bank*, 248 F.R.D. 478, 482 (W.D. Ky. 2008) ("It is commonly recognized that an agent is responsible for his own tortious acts, notwithstanding the agency relationship and regardless of whether the principal is also liable. Restatement (Third) of Agency, § 7.01 (2006)."); *Smith v. Isaacs*, 777 S.W.2d 912, 914 (Ky. 1989) ("the agent of a corporation, albeit a principal shareholder and officer of the corporation, is personally liable for a tort committed by him although he was acting for the corporation.", quoting *Peters v. Frey*, 429 S.W.2d 847, 849 (Ky. 1968)); *Young v. Vista Homes, Inc.*, 243 S.W.3d 352; 363 (Ky. App. 2007) ("an agent or corporate officer is not immune from liability for his own intentional misconduct or for negligence based upon a breach of his own duty.") (citations omitted).

30. *Barone*, 2008 WL 2468792 at \*2.

31. See Comment B to the RESTATEMENT (THIRD) OF THE LAW OF AGENCY § 6.01 (2006).

32. *Id.*

33. KY. REV. STAT. ANN. § 275.003(1).

34. *Barone*, 2008 WL 2468792 at \*4.

them as employees.<sup>35</sup> Moreover, the court does not explain how the liability shield of the LLC Act would be applied differently between a “member” and an “employee,” especially as the rule of limited liability encompasses any “member, manager, employee or agent of” an LLC.<sup>36</sup> In addition, because Glen Perkins LLC was member-managed, both Perkins and Hacker were imbued with apparent agency authority on behalf of the LLC in its ordinary course of business.<sup>37</sup>

In response to the *Barone* court’s attempts to differentiate between the limited liability provided by the KyBCA and the LLC Act, and its reliance upon the express statutory language incorporating the general rule set forth in agency law, the 2010 Amendments revised the limited liability provision of the LLC Act<sup>38</sup> to incorporate Section 7.01 of the Restatement (Third) of the Law of Agency, as embodied in KRS § 271B.6-220(2). The 2010 Amendments also made parallel revisions to the provisions of the Kentucky Uniform Limited Partnership Act (2006),<sup>39</sup> the Kentucky Cooperatives and Associations Act,<sup>40</sup> the

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35. See, e.g., TREAS. REG. § 301.7701-2(c)(iv)(A) (while liability for trust fund taxes on compensatory payments made to a non-member employee of a single member LLC will be a liability of the LLC, payments to members are self-employment income and liability for trust fund taxes, and considered personal to each member); REV. RUL. 69-184, 1969-1 C.B. 256 (a bona fide partner in a partnership is not an “employee” of the partnership for purposes of FICA, FUTA and withholding obligation or “under the usual common law rules applicable in determining the employer – employee relationship”); RESTATEMENT OF THE LAW (THIRD) EMPLOYMENT LAW (Tentative Draft No. 2 (April 3, 2009)) § 1.03 (“Unless otherwise provided by law, an individual is not an employee of an enterprise if the individual through an ownership interest controls all or part of the enterprise.”); KY. REV. STAT. ANN. § 342.012(1) (a “qualified member” of an LLC, defined at KRS § 342.012(3), is protected by worker’s compensation only if there is an affirmative election of coverage).

36. KY. REV. STAT. ANN. § 275.150(1).

37. *Barone*, 2008 WL 2468792 at \*1. See also KY. REV. STAT. ANN. § 275.135(1).

38. The LLC Act has been revised by adding a new subsection (3) to KRS § 275.150 providing that the general rule of limited liability “shall not affect the liability of a member, manager, employee or agent of a [LLC] for his own negligence, wrongful acts, or misconduct.” See 2010 Acts, ch. 133, § 31. This addition, which reflects the law of an authorized agent’s responsibility for his or her conduct, should be distinguished from the liability imposed on a purported agent when acting on behalf of a non-existent principal or outside the scope of the agent’s actual authority. Both are addressed at KRS § 275.095. It bears noting that the overbroad reading by the *Barone* Court of the absence in KRS § 275.150 of language equivalent to KRS § 271B.6-220(2) was avoided in *J. Stan Dev., LLC v. Lindo*, No. 2008-CA-001796-MR, 2009 WL 3878084 (Ky. App. Nov. 20, 2009) and *Dzurilla v. All American Homes, LLC*, 2010 WL 55923 at \*3 (E.D. Ky. Jan. 4, 2010).

39. The amendments to KyULPA (2006) are made in two sections, namely the addition of KRS § 362.2-303(2) and KRS § 362.2-404(4). These amendments address, respectively, the liability shield afforded all limited partners in a KyULPA limited partnership and as well the general partners in a KyULPA limited partnership that is elected to be a limited liability limited partnership. See 2010 Acts, ch. 133, §§ 61-62. The presence of a provision of this nature in KyRUPA at the time of its adoption was a carry-forward from the predecessor LLP act. See KY. REV. STAT. ANN. § 362.1-306(4); *id.* § 362.220(3); see also Allan W. Vestal and Thomas E. Rutledge, *Modern Partnership Law Comes to Kentucky: Comparing the Kentucky Revised Uniform Partnership Act and the Uniform Act from which it was Derived*, 95 KY. L.J. 715, 731, note 102 and accompanying text (2006-07).

Rural Electric & Telephone Cooperative Act,<sup>41</sup> and the Kentucky Nonprofit Corporation Act.<sup>42</sup>

The statutory recognition that one is subject to liability for their own torts does not modify duties *inter se* the various business organizations. Just as the "except that he may become personally liable by reason of his own acts or misconduct" language of KRS § 271B.6-220(2) neither limits nor modifies the director's standard of culpability for breach of the duty of care,<sup>43</sup> the addition of equivalent language in the other acts does not modify the responsibilities *inter se* the business organization. To that end, the addition of Restatement § 7.01 language to the statutes identified above does not: (a) modify the standard of culpability for a breach of the duty of care;<sup>44</sup> (b) affect the ability to modify (or even eliminate) that duty of care or culpability for its violation;<sup>45</sup> or (c) otherwise create a basis for liability.

### III. BRINGING SUIT ON BEHALF OF AN LLC

KRS § 275.335 identifies who has the authority to initiate a legal action on behalf of and in the name of an LLC.<sup>46</sup> KRS § 275.340 provided that the determination that a person did not have not proper authority to initiate an action on behalf of an LLC could not be "asserted as a defense to an action brought by the LLC or as the basis for the LLC to bring a subsequent suit in the

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40. In the Cooperatives and Associations Act, a series of amendments were necessary. First, subsection (3) of KRS § 272.201 has been deleted, 2010 Acts, ch. 133, § 13, and replaced with new section KRS § 272.203, created by 2010 Acts, ch. 133, § 3. That new KRS § 272.203, patterned upon KRS § 271B.6-220, provides the rule of limited liability and as well the rule that a member or other person acting on behalf of an association is liable for consequences of his or her own actions. In addition, a new subsection (2) has been added to § 272.490, that subsection repeating the rule of KRS § 271B.6-220. See 2010 Acts, ch. 133, § 14.

41. Sections 279.090 and 279.390 of KRS have been revised to incorporate language based upon KRS § 271B.6-220(2). See 2010 Acts, ch. 133, §§ 47, 48.

42. In the Nonprofit Corporation Act, KRS § 273.187 has been redrafted to restate the rule of limited liability while, at the same time, repeating the rule of personal liability for one's own conduct. See 2010 Acts, ch. 133, § 15.

43. KY. REV. STAT. ANN. § 271B.8-300(5).

44. See, e.g., KY. REV. STAT. ANN. § 275.170(1).

45. See, *id.* § 275.180(1).

46. The authority to bring an action on behalf of an LLC may be expanded or restricted in the LLC's operating agreement. See KY. REV. STAT. ANN. § 275.335 ("Unless otherwise provided in a written operating agreement"). In *Maitland v. Int. Registries, LLC*, 2008 WL 2440521 (Del. Ch. June 6, 2008), the fifty-percent member of an LLC filed suit against the LLC; the other member sought, on behalf of the LLC, to retain counsel and defend the suit. The operating agreement in question provided that "the decision of the members holding a majority of the LLC interest as to all such matters shall be controlling." On that basis, the court determined that the second member did not have the authority to retain counsel on behalf of the LLC. Similarly, in *Ward v. Hornik*, 2002 WL 1199249 (E.D.Pa. June 3, 2002), a complaint authorized by members holding sixty-four percent of the voting interests was dismissed when the operating agreement required two-thirds of the voting interests to take action.

same cause of action.” KRS § 275.340 has caused mischief by its application in a manner not intended. Consequently, it has been deleted.<sup>47</sup>

The rationale for this provision was twofold. The first was to preclude an LLC that did not prevail in an action brought in its name from asserting that it was not bound by the action, thereby avoiding issues of res judicata, collateral estoppel, law of the case, claim preclusion, and the like. The second rationale for the provision was to preclude defendants sued by an LLC from being able to have the action dismissed due to lack of authority. Otherwise, the LLC had to take whatever steps necessary to authorize the action, during which time the statute of limitations on its claim may have run or the defendant may have otherwise realized additional defenses.<sup>48</sup>

This statute had not been applied in actions between the LLC and third parties, but rather in actions *inter se* the members. In *Lourdes Medical Pavilion, LLC v. Catholic Health Care Partners, Inc.*,<sup>49</sup> the operating agreement at issue required the consent of both LLC members to initiate legal action on behalf of the LLC.<sup>50</sup> One member, in its own name and on behalf of the LLC, brought an action against the other member.<sup>51</sup> The court found that, in bringing the action, the plaintiff member acted outside the bounds of the operating agreement.<sup>52</sup> However, citing KRS § 275.340, the Court determined that the action should not be dismissed - notwithstanding the lack of actual authority in the plaintiff member to bring suit on behalf of the LLC against the other member.<sup>53</sup> The *Lourdes* court eviscerated KRS § 275.335<sup>54</sup> and ignored the “maximum enforcement of operating agreements” directive in KRS § 275.003(1).<sup>55</sup> To avoid this and similar results, the 2010 Amendments repealed KRS § 275.340.<sup>56</sup> Actual authority to bring an action on behalf of an LLC will continue to be determined under the operating agreement and KRS § 275.335. Courts will

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47. Repealed by 2010 Kentucky Laws Ch. 133 (S.B. 150).

48. KRS § 275.340 is based upon Section 1103 of the Prototype Limited Liability Company Act, the primary source document for the original 1994 Kentucky LLC Act. See *infra* notes 154 and 185. The official comment to Prototype LLC Act § 1102 (KRS § 275.345) provides in part “Section 1103 provides for the consequences of unauthorized suits vis-à-vis third parties.”

49. 2006 U.S. Dist. LEXIS 12550 (W.D. Ky. Mar. 22, 2006). My thanks to Edward “Eddie” Jones, currently of the Paducah office of Boehl, Stopher & Graves LLP, for bringing this case to my attention.

50. *Id.* at \*6.

51. *Id.* at \*4.

52. *Id.* at \*10-11.

53. *Id.* at \*14. Although not an issue in this decision, it must be wondered whether the defendant member had a viable cause of action against the plaintiff member for breach of the operating agreement and, if so, what would be the damages.

54. See KY. REV. STAT. ANN. § 275.335 (reciting who may bring suit on behalf of an LLC and making that authority subject to a contrary rule in a written operating agreement).

55. At the time of the *Lourdes* decision, the “maximum enforcement of operating agreements” language was codified at KRS § 275.015(14). See also Rutledge, *The 2007 Amendments*, *supra* note 1 at 260, n. 210.

56. See 2010 Acts, ch. 133, § 77.



instead make determinations as to whether the action has been properly authorized and whether the LLC is bound by any judgment rendered under generally applicable principles of law.<sup>57</sup>

#### IV. LIMITS ON DISTRIBUTIONS BY LIMITED LIABILITY PARTNERSHIPS

The various legislative acts that provide limited liability to the owners of business entities<sup>58</sup> also provide limits on the distributions that may be made to those owners. These limits preserve the concept of creating a "trust fund" to insure that some assets remain available to satisfy the claims of more senior creditors.<sup>59</sup> Under these various limitations, when certain tests are not satisfied, the entity may not make a distribution to its owners.<sup>60</sup> The notable exceptions to this rule had been the limited liability partnership provisions in the Kentucky Uniform Partnership Act ("KyUPA")<sup>61</sup> and the Kentucky Revised Uniform Partnership Act ("KyRUPA").<sup>62</sup> Prior to the 2010 Amendments, neither of these statutes provided limitations upon distributions that a LLP could make.<sup>63</sup> The 2010 Amendments added limitations on distributions by an LLP when the LLP is insolvent or would be made insolvent by the distribution.<sup>64</sup> Each of the new provisions provides a two-year "look back" period for recovery from those that authorized an improper distribution.<sup>65</sup> These new provisions are similar to

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57. In this respect, the deletion of KRS § 275.340 from the LLC Act does not create a gap in the Act. None of the KyRUPA, KyULPA, Kentucky Business Corporation Act ("KyBCA"), Kentucky Nonprofit Corporation Act ("KyNPCA"), or other business organization acts contains a provision equivalent to KRS § 275.340.

58. This reference to "owners" includes corporate shareholders, members in an LLC, partners in the various forms of partnerships, and others.

59. See KY. REV. STAT. ANN. § 271B.6-400(3); *id.* § 275.225(1); *id.* § 362.473 and *id.* § 362.2-508. See also BAYLESS MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL 46 (3rd ed.), citing *Wood v. Dummer*, 30 F.Cas. 435 (No. 17,944) (C.C.D. Me. 1824); *In re Mortgage America Corp.*, 714 F.2d 1266, 1269 (5th Cir. 1983); *Bear, Inc. v. Smith*, 303 S.W.3d 137, 146 (Ky. App. 2010), quoting *Reeves v. East Cairo Ferry Co.*, 158 S.W.2d 937, 938 (Ky. 1942).

60. See KY. REV. STAT. ANN. § 271B.6-400(3); *id.* § 275.225; *id.* § 362.473; *id.* § 362.2-508.

61. See *id.* § 362.555; *id.* § 362.220(2).

62. See KY. REV. STAT. ANN. §§ 362.1-1001 through 1-1003; *id.* 362.1-306.

63. Absent an election to be an LLP there is no need for a provision limiting distributions; a creditor claim is enforceable against the partners. See *id.* § 362.220(1); *id.* § 362.1-306(1).

64. See *id.* § 362.1-1003, created by 2010 Acts, ch. 133, § 5; *id.* § 362.601, created by 2010 Acts, ch. 133, § 4. Notably, even in the absence of a statutory limitation on distributions, fraudulent conveyance law would apply.

65. See KY. REV. STAT. ANN. §§ 362.601(2); 362.1-1003(2). Accord KY. REV. STAT. ANN. § 271B.8-330(3); *id.* § 275.230(3); *id.* § 362.2-509(4). See also *Wilson v. Paine*, 288 S.W.3d 284 (Ky. 2009); Mary C. Garris, *Adverse Domination—Tolling the Statute of Limitations in Kentucky Business Organizations* (pt. I), 99 KY. L.J. ONLINE 36 (2011), [http://kentuckylawjournal.org/m/PDF/KLJO\\_201103\\_Garris1.pdf](http://kentuckylawjournal.org/m/PDF/KLJO_201103_Garris1.pdf); and Mary C. Garris, *Adverse Domination—Tolling the Statute of Limitations in Kentucky Business Organizations* (pt. II), 99 KY. L.J. ONLINE 50 (2011), [http://kentuckylawjournal.org/m/PDF/KLJO\\_201104\\_Garris2.pdf](http://kentuckylawjournal.org/m/PDF/KLJO_201104_Garris2.pdf).

provisions that have been added by several other states, most recently Ohio in its 2008 adoption of Revised Uniform Partnership Act.<sup>66</sup>

#### V. EFFECT OF THE DISSOLUTION OF AN LLC

The provision addressing the effects of the dissolution of an LLC<sup>67</sup> has been both clarified and corrected.<sup>68</sup> Previously subsection (3)(d) provided that dissolution did not change several individual rules of the operating agreement<sup>69</sup> or the Act.<sup>70</sup> Such a selective listing, however, raised the question whether items not listed were altered by dissolution. The 2010 Amendments revised the text of § 275.300(2) to answer that question by stating that unless the operating agreement provides to the contrary, dissolution does not amend the operating agreement.<sup>71</sup> Furthermore, the revised text expressly states that dissolution does not in and of itself terminate capital contribution obligations previously undertaken.<sup>72</sup>

Furthermore, all of pre-revision KRS § 275.300 was prefaced with “unless otherwise provided in a written operating agreement,” thereby implying that it set forth only default rules that are subject to private ordering.<sup>73</sup> Certain substantive provisions, however, were clearly not subject to contrary private ordering, examples being the restriction of a dissolved LLC to those activities “appropriate to wind up and liquidate its business and affairs”<sup>74</sup> and the provision that pending actions are not abated by dissolution.<sup>75</sup> Therefore, the

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66. See OHIO CODE § 1776.84. Subsection (3) of this new provision, excluding from the definition of “distribution” certain compensatory payments, parallels the provisions of KRS §§ 275.225(7) and 362.2-508(8). See also Rutledge, *The 2007 Amendments*, *supra* note 1 at 259; Thomas E. Rutledge and Allan W. Vestal, *The Uniform Limited Partnership Act (2001) Comes to Kentucky: An Owner’s Manual*, 34 N. KY. L. REV. 411, 459 (2007).

67. KY. REV. STAT. ANN. § 275.300.

68. See 2010 Acts, ch. 133, § 59.

69. For example, it was stated that quorum requirements are not altered. KY. REV. STAT. ANN. § 275.300(3)(d). Any quorum requirements must arise from the operating agreement as the LLC Act is silent as to quorum.

70. For example, this presumably refers to the standards applicable to members and managers, at a minimum KRS § 275.170 and KRS § 275.185(3). See KY. REV. STAT. ANN. § 275.300(3)(c).

71. KY. REV. STAT. ANN. § 275.300(3)(d) as amended by 2010 Acts, ch. 133, § 39. This clarification needs to be understood in the context of the rule that an LLC exists after its dissolution (see KY. REV. STAT. ANN. § 275.300(2)) and that the dissolution does not effect a member’s disassociation from the LLC. See KY. REV. STAT. ANN. § 275.280.

72. *Id.* § 275.300(3)(d) as amended by 2010 Acts, ch. 133, § 39. This provision is in partial affirmance of the ruling of the Court of Appeals in *Racing Investment Fund 2000, LLC v. Clay Ward Agency, Inc.*, No. 2007-CA-002282-MR, 2008 WL 5102151 (Dec. 5, 2008), wherein, notwithstanding the dissolution of an LLC with capital call provisions in its operating agreement, the Court found that capital calls could be made against the various members in order to satisfy a company obligation. “Therefore, RIF, albeit dissolved, still exists as a legal entity subject to a capital call.” Slip op. at 8.

73. KY. REV. STAT. ANN. § 275.300

74. *Id.* § 275.300(2).

75. *Id.* § 275.300(3)(c), recodified by 2010 Acts, ch. 133, § 39 to KY. REV. STAT. ANN. § 275.300(4)(b).

2010 Amendments revised the section to provide greater clarity to those provisions that are subject to private ordering. Now subsections (1) and (3) are expressly subject to modification in a written operating agreement while subsections (2) and (4) are not.<sup>76</sup>

## VI. FOREIGN LIMITED PARTNERSHIPS TRANSACTING BUSINESS IN KENTUCKY

Addressing a lacuna in the Kentucky Uniform Limited Partnership Act (2006) ("KyULPA"), the 2010 Amendments added a new section which makes clear the consequences to a foreign limited partnership of transacting business in Kentucky without having qualified to do so.<sup>77</sup> KRS § 362.2-911(1) provides that the limited partnership may not maintain an action or proceeding until it procures a certificate of authority.<sup>78</sup> Notwithstanding the inability of a foreign limited partnership to maintain an action if it has been transacting business without having qualified to do so,<sup>79</sup> the section expressly provides that the failure of a foreign limited partnership to qualify to do business does not impair the validity of contracts or acts of the limited partnership, nor is the foreign limited partnership precluded from defending an action in Kentucky.<sup>80</sup> Finally, the new section expressly provides that the personal liability of both general and limited partners is not impaired by the failure of the foreign limited partnership to qualify.<sup>81</sup>

## VII. ADMINISTRATIVE DISSOLUTION

Under existing law a Kentucky corporation, LLC or other business entity may be administratively dissolved for failure to maintain a registered agent or a registered office.<sup>82</sup> Before its amendment in 2007, the Kentucky Business Corporation Act ("KyBCA") called for the Secretary of State to mail notice of

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76. See *id.* § 275.300 as amended by 2010 Acts, ch. 133, § 39.

77. See *id.* § 362.2-911, created by 2010 Acts, ch. 133, § 6. This provision conforms to KRS §§ 362.507, 362.1-1103, 275.390 and 271B.15-020. The Uniform Limited Partnership Act (2001), 6A U.L.A. 325 (2008), is silent as to the consequences of a foreign limited partnership transacting business without authority. Since 2007, the foreign qualification provisions of KyRULPA have been repealed (see 2007 Acts, ch. 137, § 181) and all foreign limited partnerships qualify under KyULPA. See also Rutledge, *The 2007 Amendments*, *supra* note 1 at 235.

78. See KY. REV. STAT. ANN. § 362.2-911, created by 2010 Acts, ch. 133, § 6. In *Modern Motors, LLC v. Yelder*, No. 2009-CA-000648-MR (Ky. App. Jan. 29, 2010), the court held that KRS § 275.390(1), upon which new KRS § 362.2-911(1) is based, does not bar the filing of a compulsory counterclaim even though a compulsory counterclaim is not itself a defense.

79. See *id.* § 362.2-911(1), created by 2010 Acts, ch. 133, § 6. Accord KY. REV. STAT. ANN. § 271B.15-020(1); *id.* § 275.390(1); and *id.* § 362.1-1103(1).

80. See *id.* § 362.2-911(4), created by 2010 Acts, ch. 133, § 6. Accord KY. REV. STAT. ANN. § 271B.15-020(5); *id.* § 275.390(5); *id.* § 362.1-1103(4).

81. Accord *id.* § 362.507(3), repealed 2007 Acts, ch. 137, § 181. See also *Virginia Partners, Ltd. v. Day*, 738 S.W.2d 837, 840 (Ky. App. 1987).

82. See, e.g., KY. REV. STAT. ANN. § 271B.14-200(2); *id.* §§ 275.295(1)(b)); *id.* § 362.2-809(1)(b).

administrative dissolution to the registered agent at the registered office address.<sup>83</sup> In 2007, the KyBCA was amended to provide that the Secretary of State would send notice of administrative dissolution of a corporation to the address of the principal place of business.<sup>84</sup> Similar amendments have now been made across the KyBCA (which now addresses revocation of authority as well),<sup>85</sup> the Kentucky Nonprofit Corporation Act ("KyNPCA"),<sup>86</sup> the LLC Act,<sup>87</sup> and KyULPA.<sup>88</sup> With these amendments, notice of any administrative dissolution or revocation of a certificate of authority<sup>89</sup> will be sent to the business entities' principal place of business address.<sup>90</sup> Needless to say, these revisions make it more incumbent (it was already mandated by statute)<sup>91</sup> that business entities keep their principal address records up to date.

The 2010 Amendments added a provision to the KyNPCA addressing the dissolution of a nonprofit corporation that reaches the end of its life as defined in its articles of incorporation.<sup>92</sup> That provision - which stated that a nonprofit corporation that had reached the end of its duration as defined in its articles of incorporation would be afforded sixty days from that date within which to amend or delete that date, after which it could not be reinstated and would be required to liquidate its business and affairs - was subsequently superseded by the adoption of the Kentucky Business Entity Filing Act.<sup>93</sup> After sixty days, however, the corporation may not be reinstated and must proceed to liquidate its business and affairs.<sup>94</sup> The new provision was consistent with revisions made in 2007 to the

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83. See KY. REV. STAT. ANN. § 275.295

84. See also Rutledge, *The 2007 Amendments*, *supra* note 1 at 256.

85. See KY. REV. STAT. ANN. § 271B.15-310 as amended by 2010 Acts, ch. 133, § 11.

86. See *id.* § 273.3181 as amended by 2010 Acts, ch. 133, § 19; *id.* § 273.3182(2) as amended by 2010 Acts, ch. 133, § 20; *id.* § 273.3647 as amended by 2010 Acts, ch. 133, § 22.

87. See *id.* § 275.295(4)(a) as amended by 2010 Acts, ch. 133, § 38; *id.* § 275.445 as amended by 2010 Acts, ch. 133, § 46.

88. See *id.* § 362.2-907 as amended by 2010 Acts, ch. 133, § 68.

89. This also applies in the case of a foreign LLP qualified to transact business under KRS § 362.1-1102, a statement of foreign qualification.

90. In the case of a notice of administrative dissolution of a limited partnership governed by KyULPA, the notice will be sent to the designated office. See KY. REV. STAT. ANN. § 362.2-809(2) as amended by 2010 Acts, ch. 133, § 64. See also KY. REV. STAT. ANN. § 14A.2-010(12).

91. See, e.g., KY. REV. STAT. ANN. § 275.040 ("A [LLC] that changes the mailing address of its principal office *shall* deliver to the Secretary of State ... a statement of change ....") (*emphasis added*); *id.* § 362.2-115(1) ("In order to change its designated office, registered office or agent for service of process, a limited partnership or a foreign limited partnership *shall* deliver to the Secretary of State for filing a statement of change....") (*emphasis added*); and *id.* § 271B.5-025 ("A corporation that changes the mailing address of its principal office *shall* delivery to the Secretary of State for filing, on a form supplied by the Secretary of State, a statement of change ....") (*emphasis added*). See also KY. REV. STAT. ANN. § 14A.5-010.

92. KY. REV. STAT. ANN. § 273.3182(4), created by 2010 Acts, ch. 133, § 20.

93. *Id.* Effective January 1, 2011 this provision was superseded by KRS § 14A.8-010, created by 2010 Acts, ch. 151, § 39.

94. KY. REV. STAT. ANN. § 273.3182(4), created by 2010 Acts, ch. 133, § 20, now KRS § 14A-8-010(2)

KyBCA and the LLC Act.<sup>95</sup> As further amended, the KyBCA, the LLC Act, and the KyNPCA provide that the Secretary of State is not under an obligation to send notice of its dissolution when an entity reaches the end of its period of duration.<sup>96</sup> Consequently, it may not be argued that notice from the Secretary of State is a precondition to the dissolution of the organization upon reaching the period of duration as set forth in its organic filing.

Another revision made throughout business entity acts deals with the timing of transmission of a notice of administrative dissolution or revocation of a certificate of authority. Annual reports are due by June 30 of each year.<sup>97</sup> Previously, the statutes provided that after sixty days had elapsed from that due date, notice of administrative dissolution or of revocation of the certificate of authority would be mailed.<sup>98</sup> That notice then triggered a sixty-day cure period.<sup>99</sup> Under the revised statutes, the Secretary of State may mail notices of administrative dissolution and revocation of the certificate of authority immediately after the June 30 due date.<sup>100</sup> The sixty-day cure period is not impacted by these revisions.

#### VIII. THE PROFESSIONAL SERVICE CORPORATION ACT

The 2010 Amendments made several revisions to the Professional Service Corporation Act ("PSC Act"). Most of the revisions made in KRS § 274.017(1) are grammatical in nature, however the revisions to KRS § 274.017(1)(d) make clear that the requirement that the professional service be permitted by the articles of incorporation applies both to the corporation at issue as well as a corporation seeking to be a shareholder thereof.<sup>101</sup> The revisions to KRS § 274.017(2) confirm the ruling in *National Loan Investors, L.P. v. Retina Assoc., P.S.C.*,<sup>102</sup> which held that, notwithstanding an otherwise valid pledge agreement of the stock in a Professional Service Corporation ("PSC"), a non-professional is not a "qualified person" able to exercise on an otherwise valid pledge and take ownership of the shares.<sup>103</sup>

95. See *id.* § 271B.14-220(5); *id.* § 275.295(2)(b); see also Rutledge, *The 2007 Amendments*, *supra* note 1 at 247-48.

96. See KY. REV. STAT. ANN. § 273.3181 (1).

97. See, e.g., *id.* § 271B.16-220(3); *id.* § 275.190(3); *id.* § 362.2-210(3); *id.* § 362.1-121(3); *id.* § 273.3671(3); *id.* § 386.392(3). Effective January 1, 2011, the provision addressing the due date for annual reports will be KRS § 14A.6-010(4).

98. See, e.g., KY. REV. STAT. ANN. § 275.295(1)(a) (prior to repeal by 2010 Acts, ch. 151, § 151).

99. See, e.g., *id.* § 271B.15-310(2); *id.* § 271B.14-210(2); *id.* § 275.295(2)(b); *id.* § 275.445(2).

100. See *id.* § 271B.14-200(1) as amended by 2010 Acts, ch. 133, § 7; *id.* § 271B.15-310(1) as amended by 2010 Acts, ch. 133, § 11. Effective January 1, 2011 this provision was superseded as to its substance by KRS § 14A.7-050(1)(a) as created by 2010 Acts, ch. 151, § 35.

101. See 2010 Acts, ch. 133, § 25.

102. 2004 WL 23665589 (Ky. App. 2004).

103. See KY. REV. STAT. ANN. § 274.005(4).

The revisions to what was formerly KRS § 274.245(1)<sup>104</sup> state that the qualified shareholder requirement is to be applied as if the foreign corporation were itself incorporated in Kentucky.<sup>105</sup> The deletion of KRS § 274.245(2) serves to make two clarifications: (a) the rules applicable to whether a foreign professional service corporation must qualify to do business will be the same terms that apply to foreign business corporations in general;<sup>106</sup> and (b) the prior exception from qualification if no office is maintained in Kentucky will no longer apply.<sup>107</sup>

The amendments revised the PSC Act to explicitly provide that the rules applicable to business corporations in general, including shareholder limited liability, also apply to professional service corporations.<sup>108</sup> These rules are subject, of course, to the PSC's retention of certain supervisory liability and other applicable rules of personal liability under professional regulatory rules.<sup>109</sup> Kentucky law as it relates to shareholder liability will apply equally to the actors on behalf of a foreign PSC, notwithstanding the internal affairs doctrine, with respect to services rendered in Kentucky.<sup>110</sup>

Finally, a new provision expressly authorizes a PSC that is no longer rendering professional services to delete the PSC provisions from its articles of incorporation and thereafter be governed solely by KRS chapter 271B.<sup>111</sup>

#### IX. THE ASSUMED NAME ACT

The 2010 Amendments made minor revisions to the Assumed Name Act to add greater clarity as to what constitutes the real name of a foreign business trust or foreign not-for-profit corporation, and to add the obviously missing "certificate" to KRS § 365.015(6).<sup>112</sup>

#### X. THE CONSEQUENCES OF DEFAULTING ON OBLIGATIONS UNDERTAKEN IN AN OPERATING OR PARTNERSHIP AGREEMENT

The LLC Act, KyRUPA and KyULPA contemplate that there may be obligations to make additional capital contributions in the future, or to

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104. This provision dealt with foreign professional service corporations seeking to qualify to transact business in Kentucky.

105. See 2010 Acts, ch. 133, § 27. As of January 1, 2011, the same requirement is imposed under the Business Entity Filing Act. See KY. REV. STAT. ANN. § 14A.9-030(1)(j).

106. See KY. REV. STAT. ANN. § 271B.15-010. Effective January 1, 2010, the provision controlling whether qualification is required will be KRS § 14A.9-010.

107. *Id.*

108. See *id.* § 274.015(2); *id.* § 274.055(1).

109. See *id.* § 274.015(2) as amended by 2010 Acts, ch. 133, § 24; *id.* § 274.055(1), created by 2010 Acts, ch. 133, § 26.

110. See *id.* § 274.055(4), created by 2010 Acts, ch. 133, § 26.

111. See *id.* § 274.015(3), created by 2010 Acts, ch. 133, § 24.

112. See KY. REV. STAT. ANN. § 365.015 as amended by 2010 Acts, ch. 133, § 71.

make or perform other obligations.<sup>113</sup> Unlike the LLC Act, however, which provides that such obligations are enforceable only if set forth in writing,<sup>114</sup> neither the partnership nor the limited partnership acts contain a similar statute of frauds provision.<sup>115</sup> Each of these acts has now been supplemented to provide that the operating/partnership agreement may specify the penalties or consequences of a failure to satisfy an otherwise enforceable obligation. The statute also introduces a non-exclusive list of the penalties/consequences to which the parties may agree.<sup>116</sup> In each instance, the language adopted is based on the Delaware LLC Act.<sup>117</sup> These additions serve to rebut the argument that *Man-O-War Restaurants, Inc. v. Martin*<sup>118</sup> may still apply to LLCs and other non-corporate entities,<sup>119</sup> notwithstanding the freedom of contract principles embodied in these acts.<sup>120</sup> The 2002 amendment to KRS § 271B.6-270 overruled *Martin* as it applied to corporations.<sup>121</sup>

## XI. CHARGING ORDERS

Further revisions<sup>122</sup> have been made to the various charging order provisions. First, KyRUPA has been revised to make clear that a partner's transferee

113. Indeed, it is possible to issue corporate shares that are assessable, the constitutional prohibition thereon having been removed in 2002, but that practice is at best atypical.

114. KY. REV. STAT. ANN. § 275.200(1). See also KY. REV. STAT. ANN. § 275.150(2).

115. Compare KY. REV. STAT. ANN. § 275.200(1) with KY. REV. STAT. ANN. §§ 362.1-306(1), (3); *id.* § 362.2-404(1). See also Thomas E. Rutledge, *The Statute of Frauds and Partnership/Operating Agreements*, 11 J. PASSTHROUGH ENTITIES 33 (Nov./Dec. 2008).

116. See KY. REV. STAT. ANN. § 275.003(2), created by 2010 Acts, ch. 133, § 28; *id.* § 362.1-103(4), created by 2010 Acts, ch. 133, § 51; *id.* § 362.2-110(4), created by 2010 Acts, ch. 133, § 60. Practitioners need to be aware of the involved tax implications of such provisions. See, e.g., Steven R. Schneider and Brian J. O'Connor, *LLC Capital Shifts: Avoiding Problems when Applying Corporate Principles*, 92 J. TAX'N 13 (Jan. 2000).

117. See DEL. CODE ANN. tit. 6, § 18-502(c). Other jurisdictions with similar provisions include Ohio. See OHIO CODE § 1776.24.

118. 932 S.W.2d 366 (Ky. 1996).

119. See, e.g., Kenneth R. Sagan, *Top Ten Kentucky Business Law Oddities*, 2007 Kentucky Bar Association Annual Convention (June 22, 2007).

120. See KY. REV. STAT. ANN. § 275.003(1) ("It shall be the policy of the General Assembly through this chapter to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements...."); *id.* § 362.1-104(3) ("Subject to KRS 362.1-103(2), it shall be the policy of the Commonwealth through this subchapter to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements...."); and *id.* § 362.2-107(3) ("Subject to KRS 362.2-110(2), it shall be the public policy of the Commonwealth in this chapter to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements....").

121. See Thomas E. Rutledge, *The 2002 Amendments to the Kentucky Business Corporation Act*, 67 BENCH & BAR 13, 20-22 (May, 2003).

122. In 2007, significant revisions were made to the charging order provisions of the LLC Act (KRS § 275.260), KyRUPA (KRS § 362.1-504) and KyULPA (KRS § 362.2-703). See Rutledge, *The 2007 Amendments*, *supra* note 1 at 252-53.

benefits from exemption laws just as a partner would,<sup>123</sup> and the LLC Act has been revised for grammar and terminology. Next, the charging order provisions of KyRUPA, KyULPA, and the LLC Act have been supplemented to address procedural issues for their issuance and service, making explicit that (a) the LLC/partnership is not a necessary party to the application for a charging order,<sup>124</sup> and (b) that service of the charging order on the LLC or partnership may be made by the court or as it should direct.<sup>125</sup> Finally, the charging order provisions of KyUPA<sup>126</sup> and KyRULPA<sup>127</sup> have been deleted and replaced with the language employed in KyRUPA and KyULPA, respectively.<sup>128</sup> With these revisions, the rights of the charging order's holder are the same, irrespective of the statute governing the LLC or partnership in question.<sup>129</sup>

## XII. THE DOCTRINE OF INDEPENDENT LEGAL SIGNIFICANCE

The doctrine of independent legal significance has been expressly incorporated into the KyBCA, the LLC Act, KyRUPA and KyULPA.<sup>130</sup> Under the doctrine of independent legal significance, "[a]ction taken in accordance

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123. KY. REV. STAT. ANN. § 362.1-504(6). This revision brought the charging order provision of KyRUPA fully into accord with the charging order provision of the LLC Act (KRS § 275.265(5)) and KyULPA (KRS § 362.2-703(5)).

124. See also *Cadle Co. v. Ginsburg*, 2002 WL 725500 (Conn. Super. Ct. 2002).

125. See KY. REV. STAT. ANN. § 275.260(6), created by 2010 Acts, ch. 133, § 35; *id.* § 362.1-504(7), created by 2010 Acts, ch. 133, § 56; *id.* § 362.2-703(7), created by 2010 Acts, ch. 133, § 63.

126. *Id.* § 362.285 as amended by 2010 Acts, ch. 133, § 49.

127. *Id.* § 362.481 as amended by 2010 Acts, ch. 133, § 50.

128. See KY. REV. STAT. ANN. § 362.285 as amended by 2010 Acts, ch. 133, § 49; *id.* § 362.481 as amended by 2010 Acts, ch. 133, § 50. As to the charging order generally, see Thomas E. Rutledge, *Charging Orders: Some of What You Ought to Know (Part I)*, 9 J. PASSTHROUGH ENTITIES 15 (Mar./Apr. 2006); *(Part II)*, 9 J. PASSTHROUGH ENTITIES 21 (Jul./Aug. 2006). In contrast with Nevada (see N.R.S. § 78.746), Kentucky has not sought to include a charging provision in its business corporation act. See also Thomas E. Rutledge, *Nevada's Corporate Charging Order: Less Than Meets the Eye*, 11 J. PASSTHROUGH ENTITIES 21 (Mar./Apr. 2008).

129. For example, while the charging order provisions of KyUPA and KyRULPA were previously silent as to whether or not the charging order was the exclusive means by which the judgment creditor could move against the partnership interest, such is now express in both of those acts. All the acts now use the (seemingly) permissive "may," as contrasted with a mandatory "shall," as to the court's capacity to issue a charging order. This word accommodates the application of exemptions that may apply, but is not intended to otherwise require an evidentiary hearing to require, for example, the judgment creditor proving the judgment debtor to be a partner/member of the partnership/LLC to which the charging order is directed or that the partnership/LLC generates distributable income that will, pursuant to the charging order, be diverted in satisfaction of the judgment.

130. See KY. REV. STAT. ANN. § 271B.1-430, created by 2010 Acts, ch. 133, § 1; *id.* § 275.003(5), created by 2010 Acts, ch. 133, § 28; *id.* § 362.1-104(5), created by 2010 Acts, ch. 133, § 52; *id.* § 362.2-107(4), created by 2010 Acts, ch. 133, § 59. The failure to incorporate the rule of independent legal significance into the statutes governing seldom used structures such as the business trust was simply an exercise in efficiency, and should not be interpreted as an indication that the doctrine, as a component of the common law, does not there apply.



with different sections of that law are acts of independent legal significance even though the end result may be the same under different sections."<sup>131</sup>

This doctrine is applied in circumstances where the effect of a transaction may be accomplished in either of two manners that have different procedural or substantive requirements.<sup>132</sup> If the requirements of one "path" are satisfied, the transaction is valid notwithstanding that the requirements of another path are not satisfied.<sup>133</sup> For example, consider an LLC owned 60%/20%/20% whose operating agreement requires the consent of 80% of the members for its amendment. The 60% member holds a meeting of the members to consider a merger of the LLC into another LLC – the first LLC's operating agreement is silent as to mergers and therefore the default of approval by a majority-in-interest of the members applies.<sup>134</sup> While the two 20% members vote against the transaction, the 60% member's vote is sufficient. The members are now bound by the new operating agreement<sup>135</sup> and there is no right to dissent from the merger.<sup>136</sup> In response to the minority-member's argument that the "merger" was nothing but an amendment of the operating agreement for which 80% approval was necessary, the doctrine of independent legal significance states that the mere fact that the outcome is identical or similar does not mean it should be set aside.<sup>137</sup> Rather, an action is appropriate when a permissible means is employed to achieve a permissible end, even though the requirements to another (and perhaps more direct or restrictive) means to the same end are not employed.<sup>138</sup> These amendments track certain Delaware revisions made in 2009.<sup>139</sup> While

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131. *Orzeck v. Englehart*, 195 A.2d 375, 377 (Del. 1963). See also *Hariton v. Arco Electronics, Inc.*, 188 A.2d 123 (Del. 1963), aff'g 182 A.2d 22 (Del. Ch. 1962); *Warner Communications, Inc. v. Chris-Craft Industries, Inc.*, 583 A.2d 962, 970 (Del. Ch. 1989) (referencing "Our bed rock doctrine of independent legal significance"), and *Benchmark Capital Partners IV, L.P. v. Vague*, 2002 W.L. 1732423 (Del. Ch. July 15, 2002), aff'd sub. nom. *Benchmark Capital Partners IV, L.P. v. Juniper Financial Corp.*, 822 A.2d 396 (Del. 2003); Ernest L. Folk, III, *De Facto Mergers in Delaware: Hariton v. Arco Electronics, Inc.*, 49 VA. L. REV. 1261 (Nov. 1963). In *Lach v. Man O'War LLC*, 256 S.W.3d 563 (2008), the plaintiff argued that the transaction undertaken was invalid as the effect was indistinguishable from a conversion for which the approval of the plaintiff would have been required. The Court rejected that argument of equivalency, but on other basis determined the transaction to have been improper.

132. See *Orzeck*, 195 A.2d at 377.

133. *Id.*

134. See KY. REV. STAT. ANN. § 275.350(1). This rule is subject to modification in a written operating agreement.

135. *Id.* § 275.360(4).

136. *Id.* § 275.345(3).

137. See *Orzeck*, 195 A.2d at 377.

138. The doctrine of independent legal significance applies *inter se* the business entity and does not impact upon successor liability to third parties under cases such as *American Railway Express Co. v. Commonwealth*, 228 S.W. 433 (Ky. 1920), *Conn. v. Fales Division of Mathewson Corp.*, 835 F.2d 145 (6th Cir. 1987), *Pearson v. National Feeding Systems, Inc.*, 90 S.W.3d 46 (Ky. 2002) and *Parker v. Henry A. Petter Supply Co.*, 165 S.W.3d 474 (Ky. 2005).

139. See DEL. CODE ANN. tit 6, § 15-1201 as amended by S.B. 83, 145th Delaware General Assembly; DEL. CODE ANN. tit. 6, § 17-1101(h), created by H.B. 142, 145th Delaware General Assembly; and DEL. CODE ANN. tit. 6, § 18-1101(h), created by S.B. 82, 145th Delaware General

some may question whether this is the correct rule,<sup>140</sup> a different rule of construction may be provided for in the controlling documents.<sup>141</sup>

### XIII. MEMBER RESIGNATION

The 2010 Amendments reversed the fiduciary “lock-in” rule that had set the members of Kentucky LLC’s in an unfavorable position vis-à-vis fiduciaries in other Kentucky business entities. Directors and officers of a corporation are fiduciaries to the corporation;<sup>142</sup> absent truly extraordinary circumstances they have a unilateral power to resign from those positions and terminate their ongoing fiduciary obligations.<sup>143</sup> Likewise, general partners in a general or a limited partnership are fiduciaries<sup>144</sup> (as well as mutual agents) of the partnership and the other partners; they enjoy a unilateral power to resign as general partners and thereby terminate their ongoing fiduciary obligations.<sup>145</sup> On the other hand, shareholders, qua shareholders, are not fiduciaries to either the corporation or to the other shareholders,<sup>146</sup> and have no right to resign. Similarly, absent extraordinary circumstances, limited partners in a limited partnership are not

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Assembly. These amendments were adopted to address the ambiguity identified in *Twin Bridges L.P. v. Draper*, 2007 WL 2744609 (Del. Ch. Sept. 14, 2007). See Peter J. Walsh, Jr. & Dominick T. Gattuso, *Delaware LLCs: The Wave of the Future and Advising Your Clients About What to Expect*, 19 BUS. L. TODAY 11 (2009); Steven D. Goldberg, *2009 Delaware LLC Act Amendments* (Apr. 17, 2009), <http://blog.delawarellclaw.com/2009/04/2009-delaware-llc-act-amendments/> (last visited April 19, 2010); Louis G. Hering, *Delaware Amends Alternative Entity Statutes*, <http://blogs.law.harvard.edu/corpgov/2009/07/31/delaware-amends-alternative-entity-statutes/> (last visited April 19, 2010).

140. See, e.g., D. Gordon Smith, *Independent Legal Significance, Good Faith, and the Interpretation of Venture Capital Contracts*, 40 WILLIAMETTE L. REV. 825 at notes 22-24 and accompanying text (2004).

141. See, e.g., KY. REV. STAT. ANN. § 275.003(1) (“It shall be the policy of the General Assembly through this chapter to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements.” . . .); *id.* § 362.1-104(3) (“Subject to KRS 362.1-103(2), it shall be the policy of the Commonwealth through this subchapter to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements. . . .”); and *id.* § 362.2-107(3) (“Subject to KRS 362.2-110(2), it shall be the public policy of the Commonwealth in this subchapter to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements. . . .”).

142. See, e.g., MODEL BUS. CORP. ACT §§ 8.30(a), 8.42(a)(3); KY. REV. STAT. ANN. § 271B.8-300(1)(c); *id.* § 271B.8-420(1)(c).

143. See, e.g., 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 345.

144. See, e.g., UPA § 21, 6 U.L.A. 194 (2001); KY. REV. STAT. ANN. § 362.250; RUPA § 404, 6 U.L.A. 143 (2001); KY. REV. STAT. ANN. § 362.1-404; DEL. CODE ANN. tit. 6, §§ 15-404(b), (c); ULPA § 408, 6A U.L.A. 439 (2008); KY. REV. STAT. ANN. § 362.2-408.

145. See, e.g., UPA § 31(1)(b), 6 U.L.A. 370 (2001); KY. REV. STAT. ANN. § 362.300(1)(b); RUPA § 601(a), 6 U.L.A. 163 (2001); KY. REV. STAT. ANN. § 362.1-601(1); DEL. CODE ANN. tit. 6, § 15-601(i); IND. CODE § 23-16-7-2.

146. The inter-shareholder fiduciary obligation principles of cases following from *Donahue v. Rodd Electrotype Co. of New England*, 328 N.E.2d 505 (1975), and section 7.01(d) of the Principles of Corporate Governance are exceptional, aberrational and analytically flawed, but that is a discussion for another day.

fiduciaries. While certain statutes have afforded them the power to resign,<sup>147</sup> this power is based upon economics and not fiduciary law. Therefore, the general rule is that fiduciaries have the power to unilaterally withdraw from the office that gave rise to the fiduciary obligations and prospectively terminate those obligations.

However, prior to the 2010 Amendments, members in Kentucky LLCs found themselves in a different position. Depending on which fiduciary duty is at issue, members in a member-managed LLC owe fiduciary obligations to at least the LLC, if not the other members as well.<sup>148</sup> While in a manager-managed LLC, the members, qua members, do not *ab initio* have fiduciary obligations to either the LLC or the other members;<sup>149</sup> such obligations can arise by private ordering. What is atypical vis-à-vis other forms of organization was that members, qua members and as fiduciaries, did not have the unilateral power to terminate the position that gave rise to the fiduciary obligations *unless* that right was provided in a written operating agreement.<sup>150</sup> Absent a provision addressing the power to resign in a written operating agreement, a member desiring to resign from the LLC was at the mercy of the other members permitting him or her to do so.<sup>151</sup>

That situation could leave an LLC member in a precarious position. Consider the case of a member in a plumbing repair company organized as an LLC. That member would like to resign and set up his own plumbing company (where, as we know, he will make far more money than he would as an attorney). As a member, he owes a fiduciary duty of loyalty to the LLC, and is precluded from competing with the LLC.<sup>152</sup> If the controlling operating agreement was silent as to resignation, that member found himself at the mercy of all the other members in the current LLC. If the member were not released by the other

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147. See, e.g., RULPA § 603, 6B U.L.A. 286 (2008); IND. CODE. § 23-16-7-3.

148. KY. REV. STAT. ANN. § 275.170(1) (duty of care obligations in an LLC are owed by members, absent private ordering to the contrary, to both the LLC and the other members); *id.* § 275.170(2) (duty of loyalty obligations of members in an LLC, absent private ordering to the contrary, are owed to the LLC); RULLCA § 409(b), 6B U.L.A. 488 (2008) (member's duty of loyalty); RULLCA § 409(c), 6B U.L.A. 489 (2008) (member's duty of loyalty).

149. KY. REV. STAT. ANN. § 275.170(4); *accord* RULLCA § 409(g)(1), 6B U.L.A. 489 (2008). See also *Mitchell v. Smith*, 2009 WL 891908, \*2 (D. Utah March 31, 2009) ("Because Defendant's Counterclaim relies solely upon Plaintiff's status as members [of the LLC] for the existence of fiduciary duties, and because Utah law prohibits such a finding based solely upon membership, the Court finds that Defendant has failed to state a cause of action upon which relief may be granted."); *Katris v. Carroll*, 842 N.E.2d 221 (Ill. App. 2005); *ULQ, LLC v. Meder*, 666 S.E.2d 713 (Ga. App. 2008); *Ledford v. Smith*, 618 S.E.2d 627 (Ga. App. 2005); *Dragt v. Dragt/DeTray, LLC*, 161 P.3d 473 (Wash. App. 2007). Whether a particular LLC is member-managed or manager-managed is not determined by a substantive review and characterization of the *inter se* management structure defined in the operating agreement. Rather, as set forth in the official commentary to the Prototype LLC Act § 401, "Irrespective of the provisions in the operating agreement, whether an LLC is 'manager-managed,' as that phrase is used in the Act, depends on whether the articles of organization so provide."

150. See KY. REV. STAT. ANN. § 275.280(3) (prior to amendment by 2010 Acts, ch. 133, § 37).

151. *Id.*

152. *Id.* § 275.170(2).

members, but nevertheless opened the competing venture, then (a) there was a manifest breach of the duty of loyalty, and (b) the member was required to turn over to the LLC all profits and benefits derived from the new venture.<sup>153</sup> Understandably, from the perspective of that member desiring to open his own business, this was not an advantageous situation.

Under the LLC Act as adopted in 1994, a member had the right to unilaterally resign from the LLC.<sup>154</sup> A member's resignation (a dissociation) effected the dissolution of the company,<sup>155</sup> but if the LLC was continued by the other members, the resigning member was entitled to a liquidating distribution of the fair value of the resigning member's interest in the LLC.<sup>156</sup> This rule was merely a default, and could be modified in the written operating agreement.

In 1998, the provision allowing a member to unilaterally withdraw from an LLC was deleted from the Kentucky LLC Act, and replaced by the following provision:

Unless otherwise provided in a written operating agreement, a member has no right to withdraw from a[n] [LLC]. If the written operating agreement does not specify a time a member may withdraw, a member shall not withdraw without the consent of all other members remaining at the time.<sup>157</sup>

As a result a member had no right to withdraw from a Kentucky LLC *unless* such a right (a) is set forth in a written operating agreement or, (b) at the time resignation is desired, all of the other members consent.<sup>158</sup>

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153. *Id.*

154. *See id.* § 275.280(3) (as adopted 1994 Ky. Acts, ch. 389, § 56 and prior to amendment by 1998 Ky. Acts, ch. 341, § 37); *see also* PROTOTYPE LLC ACT § 802(C). The Prototype LLC Act was drafted by a task force of the Committee on Partnerships and Unincorporated Business Organizations, since renamed the Committee on LLCs and Unincorporated Entities, Section of Business Law, American Bar Association, and was a primary source for the initial Kentucky LLC Act. *See* Thomas E. Rutledge and Lady E. Booth, *The Limited Liability Company Act: Understanding Kentucky's New Organizational Option*, 83 KY. L.J. 1, 55-83 (1995) (hereinafter "Rutledge and Booth, *LLC Act*"). The Prototype is reproduced at 3 LARRY E. RIBSTEIN AND ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES (hereinafter "RIBSTEIN AND KEATINGE ON LLCs") APPENDIX C (2nd Ed.).

155. *See* KY. REV. STAT. ANN. § 275.285(3) (as adopted by 1994 Ky. Acts, ch. 389, § 57 and prior to amendment by 1998 Ky. Acts, ch. 341, § 38); *see also* PROTOTYPE LLC ACT § 901(c). That a dissociation affected a dissolution of the entity is an outcome consistent with the predecessor partnership law. *See* UNIF. PART. ACT § 31, 6 (pt. II) U.L.A. 370 (2001); KY. REV. STAT. ANN. § 362.300.

156. *See* KY. REV. STAT. ANN. § 275.215 as adopted by 1994 Ky. Acts, ch. 389, § 43 (repealed 1998 Ky. Acts, ch. 341, § 59); *see also* PROTOTYPE LLC ACT § 602.

157. KY. REV. STAT. ANN. § 275.280(3) (prior to amendment by 2010 Acts, ch. 133, § 37).

158. A written operating agreement may provide a threshold other than all of the members to approve, on a case by case basis, a resignation. As adopted in 1992, the Delaware LLC Act afforded a member the unilateral right to withdraw upon six months prior written notice, whereupon the former member is/was to receive the fair value of their interest in the company. DEL. CODE ANN. tit. 6, §§ 18-603, 18-604 (both as prior to 1996 amendments). Although not retroactive to LLCs formed prior to the 1996 amendments (DEL. CODE ANN. tit. 6, § 18-603), from July 31,

Having reconsidered the matter and the anomaly of a default rule under which a fiduciary may not unilaterally resign,<sup>159</sup> the legislature revised the LLC Act to provide that unless a contrary rule is set forth in a written operating agreement, a member in a member-managed LLC<sup>160</sup> may resign on thirty days notice.<sup>161</sup> In a manager-managed LLC, however, the old rule remains in place; there is no right of resignation unless it is set forth in a written operating agreement or the resignation is approved by all other members.<sup>162</sup> Absent contrary private ordering,<sup>163</sup> a member who has resigned is treated as his or her own assignee, having only the rights of an assignee.<sup>164</sup> While the addition of a member's right to resign from a member-managed LLC will to some degree limit the utility of a member-managed LLC for estate planning purposes, any actual impact upon valuation discounts should be minimal because: (a) upon resignation the former member becomes an assignee of his or her own membership interest having, consequently, the same (and no greater) economic rights as before the resignation,<sup>165</sup> (b) there is no right to liquidate the interest (i.e., capital lock-in is retained), and (c) the impact of the change can be entirely avoided by utilizing a manager-managed, rather than a member-managed, LLC.

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1996 a member of a Delaware LLC does not have a right to resign unless so provided in the operating agreement. *Id.* If resignation is permitted, absent private ordering to the contrary, the member has a right to be redeemed by the company for fair value. DEL. CODE ANN. tit. 6, § 18-604. The Revised Uniform Limited Liability Company Act ("RULLCA") provides a default rule that a member may withdraw from the LLC. *See* RULLCA § 602(1), 6B U.L.A. 502 (2008); *see also* RULLCA § 601(a), 6B U.L.A. 502 (2008). Not being referred in RULLCA § 110, these provisions may be freely modified by private ordering. A dissociation by resignation will be rightful or wrongful (a wrongful dissolution is defined in RULLCA § 601(b), 6B U.L.A. 502 (2008)), and if wrongful the disassociated member is liable to the company and in certain instances the other members for the damages caused thereby. *See* RULLCA § 601(c), 6B U.L.A. 502 (2008). *Accord* RUPA § 602(c), 6 U.L.A. 169 (2001). Upon resignation, the resigning member is a transferee of his or her own transferable interest (*see* RULLCA § 603(a)(3), 6B U.L.A. 504 (2008)), and on a prospective basis fiduciary duties owed as a member (*see* RULLCA § 603(a)(2), 6B U.L.A. 504 (2008)) and the right to participate in the LLC's management are terminated. *See* RULLCA § 603(a)(1), 6B U.L.A. 504 (2008).

159. *Τὴν Χάρυβδιν ἐκφυγὼν τῇ Σκόλλῃ περιέπεσον* ("Having escaped Charybdis I fell into Scylla"); ERASMUS OF ROTTERDAM, *THE ADAGES OF ERASMUS* 83-84 (ed. William Barker) (University of Toronto Press 2001).

160. Whether the LLC in question is member- or manager-managed is a question of positive law determined by reference to the statement made in the articles of organization. *See* KY. REV. STAT. ANN. § 275.025(1)(d); *see also* PROTOTYPE LLC ACT § 401, comment.

161. KY. REV. STAT. ANN. § 275.280(3)(a), created by 2010 Acts, ch. 133, § 37.

162. *Id.* § 275.280(3)(b), created by 2010 Acts, ch. 133, § 37.

163. *See also* Thomas E. Rutledge, *You Just Resigned – Now What? Different Paradigms for Withdrawing From a Venture*, 12 J. PASSTHROUGH ENTITIES 43 (Nov./Dec. 2009).

164. *See* KY. REV. STAT. ANN. §§ 275.255(1)(b); *id.* § 275.255(1)(c); *see also* KY. REV. STAT. ANN. § 275.280(1)(c)(3), created by 2010 Acts, ch. 133, § 37. *Accord* OHIO CODE § 1705.12 ("...[T]he withdrawing member shall be treated as if the member were an assignee of all of the member's membership interest as of the date of withdrawal."). As such, there is no right to a liquidating distribution.

165. *See* KY. REV. STAT. ANN. § 275.255(1)(b).

The references to “former members” in KRS subsections 275.310(2) and (3) have been corrected to refer to the “assignees.”<sup>166</sup> A reference to assignees was also added to KRS § 275.300.<sup>167</sup>

#### XIV. MERGERS AND CONVERSIONS

The 2010 Amendments also revised the LLC Act, KyRUPA and KyULPA sections discussing mergers. Assume that a merger’s surviving entity is an LLC, a partnership, or a limited partnership governed by the KyLLC Act, KyRUPA, or KyULPA, respectively. If the plan of merger provides for a written operating or partnership agreement, the agreement becomes binding on the members or partners in that surviving business entity.<sup>168</sup> This addition conforms to the effect of conversion provisions.<sup>169</sup> Further, the Amendments revised the LLC Act and KyULPA to provide that in a merger, the surviving entity’s articles of organization/operating agreement/certificate of limited partnership will be effective and binding upon the members/partners.<sup>170</sup> The ability to impose a contribution obligation on a member, however, is limited by the requirement that such obligations are enforceable only if “set forth in a writing signed by the member.”<sup>171</sup> It may be argued that the signed writing requirement in KRS § 275.200(1) is satisfied by becoming a member of an LLC and signing an operating agreement that, by amendment or by a merger approved by less than all members,<sup>172</sup> adds a contribution obligation. This argument, however, is at best a strained reading and conflicts with the clear intent of the provision. Nevertheless, limited partners in a limited partnership, all partners in a limited liability limited partnership, and partners in a limited liability partnership will

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166. See *id.* § 275.310(2) as amended by 2010 Acts, ch. 133, § 40 (references to “former members” deleted and replaced with “assignees”); KY. REV. STAT. ANN. § 275.310(3) (same). The “former members” appeared in section 905 of the Prototype LLC Act, upon which KRS § 275.310 was based. See also KY. REV. STAT. ANN. § 275.255(1)(b). This clarification addresses the assertion made in the dissent filed in *Spurlock v. Begley*, No. 2007-CA-002523-MR (Ky. App. Dec. 31, 2008), n. 10. While the application of KRS § 275.255(1)(d) was there ignored, the revisions made to KRS § 275.310 preclude such a reading in future controversies.

167. See *id.* § 275.300(2)(d) as amended by 2010 Acts, ch. 133, § 39. Prior to this addition, a strict reading would indicate that, notwithstanding an assignee’s rights to receive the distributions that would otherwise be made to the assignor (KY. REV. STAT. ANN. § 275.255(1)(b)), a dissolving LLC may not make distributions to assignees.

168. See *id.* § 275.365(11), created by 2010 Acts, ch. 133, § 42; *id.* § 362.1-906(7), created by 2010 Acts, ch. 133, § 57; *id.* § 362.2-1109(8), created by 2010 Acts, ch. 133, § 70.

169. See KY. REV. STAT. ANN. § 275.375(2)(d) (effect of conversion into LLC); *id.* § 362.1-904(2)(d) (effect of conversion into partnership); *id.* § 362.2-1105(2)(d) (effect of conversion into limited partnership).

170. See *id.* § 275.365(10), created by 2010 Acts, ch. 133, § 42; *id.* § 362.2-1109(7), created by 2010 Acts, ch. 133, § 70.

171. *Id.* § 275.200(1). No similar statute of frauds requirement exists in KyRUPA or KyULPA.

172. See, e.g., *id.* § 275.175(2)(a) (majority-in-interest of members may amend operating agreement); *id.* § 275.350(1) (majority-in-interest of members may approve merger).

want to protect themselves from contribution obligations being imposed by including a statute of frauds provision in the controlling partnership agreement.

It has been made express that there are no vested rights under an operating, partnership, or limited partnership agreement or certificate of limited partnership.<sup>173</sup> These provisions make clear that an otherwise permissible amendment to organizational documents and the terms of the merger or conversion does not implicate a vested right that is subject to protection.<sup>174</sup>

Under the Amendments, the conversion of a partnership into an LLC cancels any statement of partnership authority.<sup>175</sup> Previously, a conversion cancelled only a statement of registration or statement of qualification as an LLP. As the filing of a statement of partnership authority under a particular name created a "real name,"<sup>176</sup> it must be separately cancelled<sup>177</sup> if the converted LLC is to utilize the name of the converting partnership (absent its automatic cancellation by the conversion).<sup>178</sup>

#### XV. CLARIFICATION OF KRS § 275.170

The 2010 Amendments, entirely as a point of clarification and without any modification to the substantive rules already in place, supplemented KRS § 275.170(1) to make clear that it constitutes the statutory standard of care, set forth in terms of a standard of culpability, applicable to members and managers in an LLC.<sup>179</sup> Similarly, the amendments supplemented KRS § 275.170(2) to make clear that it constitutes the standard of loyalty imposed on members and managers in an LLC.<sup>180</sup>

The clarifications were a response to several court decisions that indicated a level of confusion regarding the provisions that recite the default<sup>181</sup> standards of care and loyalty. With respect to the standard of care in KRS § 275.170(1), the decision rendered in *Gaunce v. Wertz*<sup>182</sup> (which did not reflect a proper

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173. See KY. REV. STAT. ANN. § 275.003(6), created by 2010 Acts, ch. 133, § 28; *id.* § 362.1-103(6), created by 2010 Acts, ch. 133, § 51; and *id.* § 362.2-110(6), created by 2010 Acts, ch. 133, § 60. The LLC Act contained a similar provision that referred only to the articles of organization. See KY. REV. STAT. ANN. § 275.025(6); see also *id.* § 271B.10-010(2).

174. For example, having resigned from a partnership, a former partner (now a transferee) cannot assert a property interest in the terms of the partnership agreement as it existed at the point of resignation and thereby "freeze" the deal even as he or she is no longer a party to that agreement. At the same time, an amendment that impacts upon a unilateral contract would not be effective.

175. See KY. REV. STAT. ANN. § 362.1-303.

176. See *id.* § 365.015(b)(2).

177. See *id.* § 362.1-105(4).

178. *Id.* § 275.100(2).

179. See *id.* § 275.170(1) as amended by 2010 Acts, ch. 133, § 32.

180. See *id.* §§ 275.170(1), (2) as amended by 2010 Acts, ch. 133, § 32.

181. That the standards of care and loyalty may be modified in a written operating agreement is manifest from the lead-in provision of KRS § 275.170 ("Unless otherwise provided in a written operating agreement").

182. 2009 WL 803843 (W.D. Ky. March 25, 2009).

interpretation of the provision) was problematic. The *Gaunce* court failed to appreciate that the LLC Act recites the standard of care as misconduct that is “wanton or reckless.”<sup>183</sup> The *Gaunce* court wrote that the claim was not for breach of fiduciary duty, but rather for wanton or reckless misconduct.<sup>184</sup> In fact, the claim is for breach of the duty of care, and liability will only attach against the member or manager charged if the violation was itself wanton or reckless. As originally written, the Kentucky LLC Act was based primarily upon the ABA’s Prototype LLC Act,<sup>185</sup> and KRS § 275.170(1) is a verbatim adoption of section 402(A). The commentary to section 402(A) provides in part “Subsection (A) sets forth the gross negligence standard of care for those participating in management.”<sup>186</sup>

Whether, in the first instance, the member’s or manager’s aspirational standard of care should be negligence, gross negligence, or some other standard is a point not addressed in the LLC Act.<sup>187</sup> Should the fiduciary standard of care be modified in a written operating agreement, both the aspirational standard of care and the level of culpability need to be addressed.<sup>188</sup>

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183. *Id.*

184. *Id.* at \*2.

185. See *supra* note 154. The statement of the Kentucky Court of Appeals in *Randy Welty and Hartford Fire Insurance Company v. Hargus Sexton*, No. 2000-CA-002847-MR (Ky. App. Feb. 1, 2002) that “The Kentucky Limited Liability Company Act ... is generally similar to the model act promulgated by the Uniform Law Commissioners” is accurate only to the extent that the Uniform Limited Liability Company Act (ULLCA, 6B U.L.A. 545 (2008)) is similar to the Prototype. In fact ULLCA and the Prototype are more dissimilar than similar, and ULLCA was not completed until well after the 1994 LLC Act was drafted.

186. Language substantially equivalent to KRS § 275.170(1) also appears in section 409(c) of the Uniform Limited Liability Company Act (6B U.L.A. 598 (2008)), where it is expressly labeled a “duty of care,” a labeling that is carried forward in the comment. 186. A bifurcation of the standard of care and the standard of culpability is set forth in the Kentucky Business Corporation Act, wherein a director’s standard of care is defined in KRS § 271B.8-300(2), informed by KRS § 271B.8-300(1), while culpability for monetary damages does not attach except as provided in KRS § 271B.8-300(5), namely upon a demonstration that the failure to satisfy the standard of care constituted “willful misconduct or wanton or reckless disregard for the best interests of the corporation and its shareholders.” See also *Sahni v. Hock*, No. 2007-CA-001785-MR, slip op. at 14-15 (Ky. App. 2010) (complaint that corporate director breached fiduciary duty but which did not allege director “committed willful misconduct or that he acted with wanton or reckless disregard for the best interests of the corporation and its shareholders” did not “sufficiently allege a cause of action under KRS § 271B.8-300.”).

187. Contrast KY. REV. STAT. ANN. § 271B.8-300(2) (defining duty of care as that of an ordinarily prudent person in a like position); *id.* § 362.1-404(3) (stating a partial definition of duty of care as that of a reasonable person in a like position in similar circumstances and in the best interests of the partnership). Whether in a future session of the General Assembly an express aspirational standard of care, with presumably a gross negligence standard of culpability, should be substituted for the exact formula will need to be assessed.

188. A bifurcation of the standard of care and the standard of culpability is set forth in the Kentucky Business Corporation Act, wherein a director’s standard of care is defined in KRS § 271B.8-300(2), informed by KRS § 271B.8-300(1), while culpability for monetary damages does not attach except as provided in KRS § 271B.8-300(5), namely upon a demonstration that the failure to satisfy the standard of care constituted “willful misconduct or wanton or reckless disregard for the best interests of the corporation and its shareholders.” See also *Sahni v. Hock*,



The formula employed in Prototype LLC Act section 402(A) and KRS § 275.170(1), reciting only the standard of culpability without a corresponding standard of care is curious, but it is clear that the standard of care is set forth in the statute.<sup>189</sup> In effect, absent private ordering to the contrary, the standard of care in an LLC is the same standard as the limit of the protections provided by the Business Judgment Rule.<sup>190</sup> Whether and when the Business Judgment Rule should apply in the contractual realm of LLCs and other unincorporated business organizations is subject to debate,<sup>191</sup> but careful drafting of an operating agreement defining standards of care and culpability differing from KRS § 275.170(1) will avoid that issue.

The standard of loyalty set forth in KRS § 275.170(2)<sup>192</sup> is a verbatim adoption of section 402(B) of the Prototype, for which the commentary provides in part:

Subsection (B) which is based on UPA § 21, sets forth the duty of loyalty of LLC managers and managing members — that is, the duty to act without being subject to an obvious conflict of interest.

The duty of loyalty under this section is defined to include two major components: “self-dealing,” that is, a manager’s reaping an individual profit by or through an LLC transaction in which the manager participated; and liability for appropriating for personal use property belonging to the LLC without the firm’s consent. Such appropriation, in effect, would amount to unauthorized compensation. This duty is based on the fact that LLC property is owned by the firm as a whole rather than by individual managers or members.<sup>193</sup> Note that “property” is defined to include records of the LLC that are in the manager’s control. Because of the similarity of this section with the UPA,<sup>194</sup> it was anticipated that the courts would interpret a section such as this to impose duties

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No. 2007-CA-001785-MR, slip op. at 14-15 (Ky. App. 2010) (complaint that corporate director breached fiduciary duty but which did not allege director “committed willful misconduct or that he acted with wanton or reckless disregard for the best interests of the corporation and its shareholders” did not “sufficiently allege a cause of action under KRS § 271B.8-300.”)

189. See KRS § 275.170; PROTOTYPE LLC ACT, § 402.

190. See PROTOTYPE LLC ACT, § 402 Commentary (“This is similar to the standard commonly applied to corporate directors, managing partners, or general partners of limited partnerships. In general, as long as managers avoid self-interested and grossly negligent conduct, their actions are protected by the business judgment rule.”); see also *Horton v. United Light, Heat and Power Co.*, 690 S.W.2d 382, 389-90 (Ky. 1985) (equating “wanton and reckless” with “gross negligence”); *Turner v. Werner Enterprises, Inc.*, 442 F. Supp.2d 384, 385 (E.D. Ky. 2006) (quoting *Kinney v. Butcher*, 131 S.W.3d 357, 359 (Ky. App. 2004)); 57A AM.JUR.2D *Negligence* § 232.

191. See, e.g., Elizabeth S. Miller and Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations*, 30 DEL. J. CORP. L. 343 (2005).

192. Certain aspects of the following discussion have previously appeared in Thomas E. Rutledge and Professor Thomas Earl Geu, *The Analytic Protocol for the Duty of Loyalty Under the Prototype LLC Act*, 63 ARK. L. REV. 473 (2010).

193. See KY. REV. STAT. ANN. § 275.240(1).

194. See UPA § 21(1), 6 U.L.A. 194 (2001), adopted in Kentucky at KRS § 362.250(1).

similar to those in the general partnership, including the duty not to appropriate partnership opportunities.<sup>195</sup>

The decision in *Patmon v. Hobbs* drove the need for clarification of KRS § 275.170(2).<sup>196</sup> When discussing the existence and quality of the duty of loyalty in LLCs, the *Patmon* decision is an instance of “partial right answer but wrong reason.” Because it was the impetus for the amendment of KRS § 275.170(2), a review of the decision is worthwhile.

The Kentucky LLC Act is based upon the Prototype LLC Act,<sup>197</sup> and contains a verbatim adoption of Prototype section 402(B)’s duty of loyalty.<sup>198</sup> In *Patmon v. Hobbs*, the Kentucky Court of Appeals addressed the existence and quality of the duty of loyalty in LLCs.

Hobbs, the 51% managing-member of American Leasing and Management, LLC (“American Leasing LLC”), a member-managed LLC,<sup>199</sup> purported to

195. PROTOTYPE LLC ACT § 402 Commentary. Language equivalent to KRS § 275.170(2) also appears in section 409(b)(1) of the Uniform Limited Liability Company Act (6B U.L.A. 597 (2008)), language labeled as and described in the comment thereto as a duty of loyalty. A comparison of KRS §§ 275.170(2) and 362.250(1) make manifest that the law developed under the latter must inform the interpretation of the former:

KRS § 362.250(1)	KRS § 275.170(2)
Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.	Each member and manager shall account to the limited liability company and hold as trustee for it any profit or benefit derived by that person without the consent of more than one-half (1/2) by number of the disinterested managers, or a majority-in-interest of the members from: (a) Any transaction connected with the conduct or winding up of the limited liability company; or (b) Any use by the member or manager of its property, including, but not limited to, confidential or proprietary information of the limited liability company or other matters entrusted to the person as a result of his status as manager or member.

See also *Prudential Building & Loan Ass’n v. City of Louisville*, 464 S.W.2d 625, 626-27 (Ky. 1971).

196. 280 S.W.3d 589 (Ky. App. 2009). The *Patmon* decision is the first published ruling of a Kentucky court addressing KRS § 275.170. This decision was not appealed to the Kentucky Supreme Court. The unpublished ruling in *Welty v. Sexton*, No. 2000-CA-002847-MR (Ky. App. Feb. 1, 2002), addressed KRS § 275.170(2), but did not review it as the fiduciary standard of loyalty or address the remedy for a breach thereof.

197. See *supra* note 154.

198. In 2007, after this dispute was initiated, the Kentucky adoption of Prototype LLC Act § 402(B) was amended (see Rutledge, *The 2007 Amendments*, *supra* note 1 at 248-49), but not in a manner relevant to this dispute. Curiously, KRS § 275.170(2), as quoted by the Court of Appeals (280 S.W.3d at 595), is the statute as it existed after its amendment in 2007, and not as it existed in 2004, while it is paraphrased (*id.* at 598) in its 2004 form.

199. Whether a particular LLC is member-managed or manager-managed is not determined by a substantive review and characterization of the *inter se* management structure defined in the operating agreement. Rather, reference is made to the election made in the articles of organization. See, e.g., PROTOTYPE LLC ACT § 202(D); KY. REV. STAT. ANN. § 275.025(1)(d). As set forth in the

transfer certain build-to-suit lease agreements between that LLC and a third party to an LLC of which Hobbs was the sole owner.<sup>200</sup> Hobbs did not seek approval for the transfers from the other members of American Leasing LLC<sup>201</sup> and it received nothing in consideration for the transferred agreements.<sup>202</sup> Patmon, a member of American Leasing LLC, brought suit against Hobbs individually and in the name of the LLC. The trial court required that Hobbs reimburse American Leasing LLC for out-of-pocket expenditures that benefited his separate LLC, but it determined that no damages were due the LLC consequent to Hobbs' transfer of the build-to-suit lease agreements because the LLC was not in a financial condition to perform on the contracts.<sup>203</sup>

On appeal, the Kentucky Court of Appeals found that Hobbs violated his duty of loyalty to the LLC only after an unfortunate and unnecessary diversion through the business corporation act<sup>204</sup> and various decisions on fiduciary duties, such as *Steelvest*.<sup>205</sup> Only the *Patmon* decision's conclusion focused on the language of KRS § 275.170(2) and (correctly) identified it as the statutory recitation of the standard of loyalty for Kentucky LLCs.<sup>206</sup> Thereafter, the Court determined that Hobbs had violated his duty of loyalty<sup>207</sup> and was liable for damages but only after: (a) stating that Kentucky courts have not determined

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comment to Prototype section 401, "Irrespective of the provisions in the operating agreement, whether an LLC is 'manager-managed,' as that phrase is used in the Act, depends on whether the articles of organization so provide."

200. *Patmon*, 280 S.W.3d at 591.

201. See KY. REV. STAT. ANN. § 275.170(2) (addressing requirement of disinterested approval of what is otherwise a conflict of interest transaction).

202. *Patmon*, 280 S.W.3d at 592.

203. *Id.* at 593.

204. Treating, it would seem, the corporate model of fiduciary duties in general and its duty of loyalty in particular as the normative paradigm for all business organizations, a point of reference neither supported in the decision nor supportable in general. Rather, choice of entity matters. The rights, duties and obligations of participants in different types of business structures are different depending upon the type selected. *Patmon*, 280 S.W.3d at 593-94. There likely exist no normative rights and duties, with the exception of the contractual obligations of good faith and fair dealing, that apply universally to business organizations irrespective of form.

205. *Patmon*, 280 S.W.3d at 598. See also *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky. 1991).

206. *Patmon*, 280 S.W.3d at 598. Consequent to this decision, KRS § 275.170(2) was amended to expressly label it as the LLC Act's duty of loyalty provision. See KY. REV. STAT. ANN. § 275.170(2) as amended by 2010 Acts, ch. 133, § 32.

207. *Patmon*, 280 S.W.3d at 593. As detailed in a leading treatise on partnership law, "A partner cannot, without the consent of his partners, acquire for himself a partnership asset, e.g., by substituting a contract with himself for one with the partnership...." ALAN R. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 390 at note 59 (West 1968) (citations omitted). "Nor may he divert to his own use or profit a 'partnership opportunity.'" *Id.* at 391, note 62 (citation omitted). See also II ALAN R. BROMBERG AND LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP (hereinafter "BROMBERG & RIBSTEIN ON PARTNERSHIP") § 6.07(c) (listing, as an example of taking an unauthorized benefit from partnership property "taking over a partnership contract") (citations omitted); *Mason v. Underhill*, No. 2006-CA-002144-MR (Ky. App. May 5, 2008) (quoting 59A *Partnership* AM.JUR.2D § 295 (2003) for the proposition a "partner has a duty to share with the partnership those business opportunities clearly related to the subject of its operations.").

whether members have a duty of loyalty<sup>208</sup> (notwithstanding the fact that the statute makes it clear that they do),<sup>209</sup> (b) a discussion of a possible breach of the duty of loyalty by Hobbs because he acted inconsistently with the statutory conflict of interest provision of the business corporation act,<sup>210</sup> and (c) discussing whether the existence of an opportunity is dependent upon the ability of the LLC to exercise it,<sup>211</sup> and therefore subjects the LLC to a “futility defense.”<sup>212</sup>

Hobbs, as a member of a member-managed LLC,<sup>213</sup> owed the company a statutory duty of loyalty under the LLC Act that included the duty to not use the LLC’s property for his own account.<sup>214</sup> It is unnecessary to analogize the position of a member to that of other positions in other forms of business organizations, except, perhaps, to emphasize the differences in the comparative statutory provisions that govern them. Moreover, in some circumstances, analogy to other entity statutes is not only unhelpful but also confusing.<sup>215</sup> While it may be fair to state that corporate officers and directors owe fiduciary

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208. *Patmon*, 280 S.W.3d at 593 (“In Kentucky, there is relatively little caselaw regarding limited liability companies and no caselaw concerning fiduciary duties in the limited liability company context.”). See also *Purcell v. Southern Hills Instruments, LLC*, 847 N.E.2d 991, 996 (Ind. App. 2006) (“In Indiana, there is relatively little case law regarding LLCs and no case law concerning fiduciary duties in the LLC context.”).

209. This point was recognized by the trial court, which wrote in its conclusions of law “KRS 275.170(2) creates a statutory duty of loyalty ....” *American Leasing and Management, LLC v. Hobbs*, 04-CI-4901, Jefferson Circuit Court, Div. 3 (Judge Perry), Sept. 24, 2007.

210. *Patmon*, 280 S.W.3d at 597 (“[W]e must determine not only that Hobbs’ activities breached the statutory standards found in KRS 275.170 and KRS 271B.8-310(1) ....”) (emphasis added).

211. *Id.* at 597, 598.

212. See generally 3 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 862.10. Certain courts have held that the futility defense is available only in instances of full disclosure. See *id.*, note 4 and accompanying text. This rule has been embodied in the Principles of Corporate Governance, which provide that while futility (“fairness”) may be a defense to the misappropriation of an opportunity when there has been full disclosure, it is not available in the absence of disclosure. See ALI PRINCIPLES OF CORPORATE GOVERNANCE § 5.05(a); *id.* Comment to § 5.05(a) (“Section 5.05(a) sets forth the general rule requiring a director or senior executive to first offer an opportunity to the corporation before taking it for personal advantage. If the opportunity is not offered to the corporation, the director or senior executive will not have satisfied § 5.05(a).”); see also *infra* note 238.

213. See *supra* note 199 and accompanying text.

214. See KY. REV. STAT. ANN. § 275.170(2).

215. *Patmon*, 280 S.W.2d at 594 (“For the foregoing reasons, the Court finds that Kentucky [LLCs], being similar to Kentucky partnerships and corporations, impose a common-law fiduciary duty on their officers and members in the absence of contrary provisions in the [LLC] operating agreement.”). Statements of this nature are troubling in that they fail to identify the basis upon which the purported analogy relies. For example, if LLC members are similar to corporate shareholders, how can it be concluded that the former are fiduciaries – Kentucky courts have not adopted *Donahue v. Rodd Electrotape Corp.* or § 7.01(d) of the PRINCIPLES OF CORPORATE GOVERNANCE, either imposing fiduciary obligations upon shareholders qua shareholders. The analogy would suggest that members are not fiduciaries, an analogy that must fail as the LLC Act provides expressly, in a member-managed LLC, that members are fiduciaries.

duties to the corporation and that partners owe duties to the partnership,<sup>216</sup> it does not follow that "being similar to Kentucky partnerships and corporations,"<sup>217</sup> LLCs impose fiduciary obligations upon their "officers and members."<sup>218</sup> Rather, it is the LLC Act, as modified by the operating agreement and supplemented by other private ordering, that *ab initio* imposes defined obligations.<sup>219</sup> The *Patmon* Court's determination that Hobbs was a fiduciary to American Leasing LLC was, at least initially, based on his statutory agency on behalf of the LLC.<sup>220</sup> While it is accurate that a member in a member-managed LLC enjoys apparent agency authority on behalf of the LLC,<sup>221</sup> and that all else being equal an agent bears a fiduciary duty to the principal,<sup>222</sup> the more accurate statement is that a member in a member-managed LLC owes the duties required by the controlling agreement, the LLC Act and general agency law.<sup>223</sup> For example, under agency law, an agent is held to the standard of care of simple negligence,<sup>224</sup> while under the LLC Act, a member is held to a standard of wanton or reckless misconduct.<sup>225</sup> Both agents and LLC members must observe standards of loyalty, but the LLC Act is the primary source of the conduct and liabilities of a member.<sup>226</sup> It is, at best, incomplete to say that the fiduciary standards applicable to members in a member-managed LLC first arise from the default status of agent for the company without careful statutory and factual analysis. It needs to be recognized that member fiduciary duties can be modified or even eliminated by the operating agreement.

Hobbs owed a duty of loyalty, imposed by and defined by statute, to the LLC.<sup>227</sup> In this case, the statutory duty appears not to have been modified in a

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216. *Patmon*, 280 S.W.2d at 594-95.

217. *Id.* at 295.

218. *Id.*

219. See KY. REV. STAT. ANN. §§ 275.170(1), (2); *id.* § 275.170 ("Unless otherwise provided in a written operating agreement").

220. 280 S.W.3d at 594 (citing KY. REV. STAT. ANN. § 275.135(1) (PROTOTYPE § 301(A))).

221. See KY. REV. STAT. ANN. § 275.135(1) ("(1) Except as provided in subsection (2) of this section, every member shall be an agent of the limited liability company for the purpose of its business or affairs . . .").

222. See RESTATEMENT (THIRD) OF AGENCY § 1.01.

223. For example, while on a prospective basis a member's fiduciary obligations will terminate upon ceasing to be a member (see, e.g., KY. REV. STAT. ANN. § 275.280(3)), a former member may not then utilize trade secrets learned in the course of being a member against and in competition with the LLC.

224. See RESTATEMENT (THIRD) OF AGENCY § 8.08.

225. KY. REV. STAT. ANN. § 275.170(1).

226. Compare RESTATEMENT (THIRD) OF AGENCY §§ 8.02, 8.03, 8.04 and 8.06 with KY. REV. STAT. ANN. § 275.170(2).

227. The LLC Act does not impose a fiduciary duty of good faith upon the participants in an LLC. See KRS § 275.170. While the common law of partnerships treated good faith as a fiduciary duty, no inclusion of that concept was made in the LLC Act. Moreover, in modern business organization acts, good faith is treated as a contractual, and not a fiduciary, obligation. See, e.g., KY. REV. STAT. ANN. § 362.1-404(4); *id.* § 362.2-408(4). To the extent good faith exists as a fiduciary, and not a contractual, obligation, as interpreted by the Delaware Courts, it is integrated

written operating agreement, but it is not clear that determination was ever found as a matter of fact in the case.<sup>228</sup> It is against that background that Hobbs' conduct must be assessed.

American Leasing LLC was in the build-to-suit leasing business.<sup>229</sup> After determining the real estate needs of a prospective tenant it would enter into a contract to buy the location, build a structure according to the lessee's specifications, and lease the property to the lessee.<sup>230</sup> The LLC had performed on at least one agreement with O'Reilly Auto Parts and negotiated three additional agreements with O'Reilly.<sup>231</sup> The *Patmon* court described those agreements as "pending"<sup>232</sup> when Hobbs directed that they be modified to wholly substitute the name of his separate LLC. But for one other point of modification, nothing else (it would appear) needed to be done before the contracts were executed.<sup>233</sup> It is a stretch of credibility to treat a deal so near closing as being a mere opportunity rather than a current asset - a point of distinction not relevant under the applicable duty of loyalty.

Another factual matter that curiously was not addressed by either the trial court or the court of appeals: a "consent resolution and agreement" of the members of the LLC was referenced by the Court of Appeals.<sup>234</sup> Interestingly, that document provides that any member may have other business activities, even those that compete with the company, "with the exception of O'Reilly Auto Parts, Inc."<sup>235</sup> Thus the document singled out the O'Reilly relationship as belonging to the LLC. It was only pursuant to Hobbs's authority as the "managing member" of the LLC that he had the ability to have the agreements

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as a "subsidiary element" of the duty of loyalty. See *Stone v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006).

228. While the opinion references an "Executive/Partnership Agreement," (*Patmon*, 280 S.W.3d at 591, 594) and indicates that it somehow addressed Hobbs' duty of loyalty, (*id.* at 594 ("This duty [of loyalty] is confirmed in the Executive/Partnership Agreement drafted and signed by Hobbs.")), its contents are never expanded upon. This agreement was an exhibit to the Appellant's (*Patmon*'s) brief to the Court of Appeals. *Id.*

229. *Id.* at 591.

230. *Id.*

231. *Id.*

232. *Patmon*, 280 S.W.3d at 592.

233. *Id.* (highlighting that an O'Reilly representative testified that he was prepared to sign the agreements with the LLC).

234. *Id.* at 591. This document was filed as an exhibit to the Appellants' (*Patmon*'s) Brief to the Court of Appeals.

235. This provision of the Consent Resolutions and Agreement, which otherwise appointed Hobbs the "President" and the "managing Member" of American Leasing LLC, provides in full:

FURTHER RESOLVED, that this agreement shall not be construed to require the continued or full time services of any member and each member is free to pursue such other business opportunities as he may determine in his own best interest with the exception of O'Reilly Auto Parts Inc., including without limitation, any business or venture that may be competitive with the Company.

executed in the name of his separate LLC.<sup>236</sup> His only available argument was that because of American Leasing LLC's lack of financial capacity to perform thereon, the agreements with O'Reilly were somehow not those of the LLC.<sup>237</sup>

As previously detailed, the duty of loyalty in a Kentucky LLC, embodying as it does predecessor partnership law, provides that the expropriation of the opportunity gives rise to the obligation to disgorge all of the benefits derived therefrom, irrespective of the ability of the venture to directly exploit the opportunity.<sup>238</sup> The violation of the duty to the LLC is the taking of the opportunity irrespective of the LLC's capacity to perform. That is, it is the action, not the damages, that is the focus of the duty of loyalty. It is on this point that the *Patmon* opinion clearly fails. Having determined that Hobbs diverted LLC property for his own benefit,<sup>239</sup> the court imposed upon Patmon the burden of demonstrating that the LLC had could the ability to acquire the LLC's

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236. *Id.* While Hobbs was the "managing-member," American Leasing, LLC, consequent to the terms of its articles of organization, remained member-managed. See *supra* note 199 and accompanying text.

237. See *Patmon*, 280 S.W.3d at 597 (by relying on the LLC's alleged inability to perform on the O'Reilly agreements, Hobbs implicitly acknowledged that they were otherwise LLC assets).

238. See J. WILLIAM CALLISON AND MAUREEN A. SULLIVAN, *PARTNERSHIP LAW AND PRACTICE* § 12.8 ("If an opportunity belongs to a partnership and it is not presented to it, the courts generally hold the usurping partner accountable for all profits derived from the opportunity, even when the partner argues that the partnerships did not have access to the funds or other resources with which to pursue the opportunity if it had been so offered to it."); BROMBERG & RIBSTEIN ON *PARTNERSHIP*, *supra* note 207 at § 6.07(d), text at note 83 ("If an opportunity is deemed to belong to the partnership, the courts will usually hold the usurping partners accountable (unless the other partners were aware of the opportunity and turned it down), even if the defendant claims that the partnership would have been unable or unwilling to take advantage of the opportunity if it had been offered."); 2 CARTER G. BISHOP AND DANIEL S. KLEINBERGER, *LIMITED LIABILITY COMPANIES - TAX AND BUSINESS LAW* ¶ 10.03[1][a][v] ("The 'account for' statutes therefore have dramatic implications for self-dealing transactions. If the transaction has been completed and the person with managerial authority has profited, that person must either show the required consent or disgorge all profits. It is generally no defense that the transaction was fair to the [LLC].") (citations omitted); 1 RIBSTEIN AND KEATINGE ON *LLCS*, *supra* note 154 at § 9.3, p. 9-12 ("A manager may not appropriate for personal use property belonging to the LLC without the firm's informed and disinterested consent.") (citations omitted). As detailed in a leading treatise on partnership law, "A partner cannot, without the consent of his partners, acquire for himself a partnership asset, e.g., by substituting a contract with himself for one with the partnership. . . ." CRANE AND BROMBERG ON *PARTNERSHIP*, *supra* note 207 at 390, note 59 (citations omitted). "Nor may he divert to his own use or profit a 'partnership opportunity.'" *Id.* at 391, note 62 (citation omitted). See also BROMBERG & RIBSTEIN ON *PARTNERSHIP*, *supra* note 207 at § 6.07(c) (listing, as an example of taking an unauthorized benefit from partnership property "taking over a partnership contract") (citations omitted); *Mason v. Underhill*, No. 2006-CA-002144-MR (Ky. App. May 5, 2008) (quoting 59A *Partnership* AM.JUR.2D § 295 (2003) for the proposition a "partner has a duty to share with the partnership those business opportunities clearly related to the subject of its operations.").

239. *Patmon*, 280 S.W.3d at 597 ("[T]he trial court has already determined that Hobbs's diversion of the O'Reilly build-to-suit lease projects was indeed a corporate opportunity of [the LLC] that he diverted for his own use.").

capacity to perform on the agreements.<sup>240</sup> The two positions are irreconcilable – the build-to-suit lease agreements cannot be both assets of the LLC diverted by Hobbs in violation of his fiduciary obligation,<sup>241</sup> and assets only if Patmon is able to demonstrate the capability to perform.<sup>242</sup> If Hobbs violated his duty of loyalty<sup>243</sup> the analysis should turn immediately to damages and other relief. If financial capability to perform is an element of the duty of loyalty, it would go to the question of whether company property has been appropriated. Further, if capacity to perform is a factor in defining the property, and capacity is lacking, then there has been no property and no breach of loyalty for having appropriated it.<sup>244</sup> It appears that the Court of Appeals made “ability to perform” an element of the proof of damages. This implication, however, conflicts with the court’s recognition that the contracts had value even if the LLC could not perform.<sup>245</sup>

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240. *Id.* at 598 (“[I]t is still necessary for Patmon to establish that [the LLC] had the financial wherewithal to undertake the O’Reilly project.”) See also *id.* at 599 (“Finally, Patmon will be able to present evidence as to whether [the LLC] could have taken advantage of the business opportunity of the O’Reilly build-to-suit leases.”).

241. *Id.* at 598. (“Thus, we remand this case to the trial court to determine a remedy for Hobbs’s common-law breach of fiduciary duty and failure to follow the statutory guidelines of KRS 275.170. Pursuant to KRS 275.170, at a minimum, Hobbs is required to hold in trust all benefits and profits derived by him as the result of his misuse of the build-to-suit leases.”).

242. *Id.* at 596 (“One theory of this [opportunity] doctrine holds that opportunity does not exist for a business is the business if financially unable to undertake the opportunity.”).

243. *Id.* at 598 (“[W]e remand this case to the trial court to determine a remedy for Hobbs’s common-law breach of fiduciary duty and failure to follow the statutory guidelines of KRS 275.170”).

244. *Id.* at 596 (“In Kentucky, however, the focus is on the fiduciary’s duty – not the lost opportunity.”). The *Patmon* decision does not consider whether the futility defense of financial incapacity is even available absent disclosure. See *supra* notes 213 and 239.

245. *Id.* at 598 (“Further, a possibility exists that [the LLC] could have sold its business opportunity to another venture and profited in that manner.”). See also 1 RIBSTEIN AND KEATINGE ON LLCs, *supra* note 154 at § 9.3, p. 9-15 (“Even if the firm cannot engage in the activity [due to financial inability], it should at least have the opportunity to obtain and sell an option or information about the activity to a third party or to the manager.”) This case may have been characterized as one of waste rather than as one of breach of loyalty by the appropriation of a company asset. “Waste” occurs when a venture “is caused to effect a transaction on terms that no person of ordinary, sound business judgment could conclude represent a fair exchange.” See *Steiner v. Meyerson*, 1995 WL 441999, \* 1 (Del. Ch. July 18, 1995), 21 DEL. J. CORP. L. 320, 324 (1995). In another formulation waste is “a transfer of corporate assets that serves no corporate purpose.” or for which “no consideration at all is received.” See *Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000); see also *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del.Ch. 1997). While typically seen in the context of corporations, waste can also occur (and is equally actionable) in the context of a partnership. See, e.g., *In re Dissolution of Demoville Partnership*, 26 So.3d 366 (Miss. App. 2009) (“Margaret allowed [Margie Allen] to waste partnership assets at a time when she knew her mother was suffering from dementia, which included impaired judgment and memory.”); *In re Matter of the Estate of William Brandt*, 81 A.D.2d 268, 279 (N.Y. 1981) (“We are also of the view that the trusts, as a limited partner, have standing to complain of a waste and diversion of partnership assets which results in a diminution of the value of the partnership itself with consequent effect upon the trusts’ interest therein.”); *EEC Property Company v. Kaplan*, 578 N.W.2d 381 (Minn. App. 1998) (upholding arbitrator’s determination that majority of partners engaged in waste of partnership assets by means of a below market lease agreement). It is uncontroverted that Hobbs’ act of transferring to his own LLC the O’Reilly contracts was not for



Even if lack of capacity to perform was a factor in determining whether the contracts were LLC property, the burden of proof must be on the agent and not the principal.<sup>246</sup>

Hobbs owned 51% of the LLC, Patmon owned 44%, and another party (Gray) owned 5%.<sup>247</sup> Therefore the approval of a transaction that would have otherwise violated Hobbs's duty of loyalty was vested in Patmon.<sup>248</sup> Nonetheless, Hobbs never presented the question to the other members so there was never even the opportunity for them to consent.<sup>249</sup> While the duty of loyalty modification in the consent resolution gave Hobbs the right to engage in activities competitive with those of the LLC, that right did not extend to the O'Reilly relationship.<sup>250</sup> In summary, the LLC Act provided Hobbs's conduct could have been excluded from his duty of loyalty in the operating agreement or sanctioned by the other members.<sup>251</sup> Hobbs chose neither of these avenues.<sup>252</sup> Consequently, he violated his duty of loyalty in expropriating company property to his own benefit.<sup>253</sup>

The determination that Hobbs violated his KRS § 275.170(2) duty of loyalty was correct, as was the conclusion that the O'Reilly contracts were company property. The question should have turned immediately to the matter of remedy. Initially Hobbs is obligated to surrender all profits and benefits derived from the diverted contracts.<sup>254</sup> Hobbs should not be able to reduce the amount owed by identifying proceeds that were diverted to others he brought into his new

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the purpose of advantaging American Leasing LLC and that it received no consideration for that transfer. *Patmon*, 280 S.W.3d at 592. Another possible approach would be a claim for conversion (see *Ky Ass'n of Counties All Lines Fund Trust v. McLendon*, 157 S.W.3d 626, 632 n. 12 (Ky. 2005) (reciting the elements of a claim for conversion)) by the LLC against Hobbs with the element of a demand for return either abated or waived under the doctrine of adverse domination (see *Wilson v. Payne*, 288 S.W.3d 284 (Ky. 2009)) until suit was brought.

246. See *supra* note 238; see also *Irving Trust Co. v. Deutsch*, 73 F.2d 121 (C.C.A. 2d Cir. 1934) ("If directors are permitted to justify their conduct on such a theory, there will be a temptation to refrain from exerting their strongest efforts on behalf of the corporation since, if it does not meet the obligations, an opportunity of profit will be open to them personally."); *Northeast Harbor Golf Club, Inc. v. Harris*, 661 A.2d 1146, 1149 (Me. 1995) ("Reliance on financial ability will also act as a disincentive to corporate executives to solve corporate financing and other problems.").

247. *Patmon*, 280 S.W.3d at 592.

248. See KY. REV. STAT. ANN. § 275.170(2) (conflict of interest may be waived by majority-in-interest of the disinterested members).

249. *Patmon*, 280 S.W.3d at 595 ("Hobbs concedes and the court found that he never obtained consent from any member of [the LLC]").

250. See *supra* notes 234-235 and accompanying text.

251. *Patmon*, 280 S.W.3d at 594.

252. *Id.*

253. *Id.*

254. KY. REV. STAT. ANN. § 275.170(2) ("shall account to the [LLC] and hold as trustee for it ....").

venture;<sup>255</sup> the fruits of the expropriation should not be reduced by the value of gain transferred to other actors.<sup>256</sup> A claim for attorney fees has substantial authority,<sup>257</sup> as does a claim for punitive damages.<sup>258</sup>

#### XVI. MISCELLANEOUS REVISIONS

The following revisions were also added to Kentucky's business entity acts, but did not fit in the above discussions, or otherwise warrant a section of their own.

The provision addressing the conversion of a corporation into an LLC has been revised only to address a grammatical error.<sup>259</sup>

An erroneous cross-reference in KyULPA has been addressed in KRS § 362.2-110(2)(d).

A *Dartmouth College*<sup>260</sup> provision has been added to KyULPA.<sup>261</sup>

The revisions made to KRS § 275.225 make clear that an improper distribution includes one that violates the operating agreement<sup>262</sup> and clarifies that it is not the LLC that determines that a distribution is proper, but rather the member or manager acting on its behalf.<sup>263</sup>

The LLC Act has been amended to make clear that an assignor member does not vote with respect to whether their assignee should be admitted as a member

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255. *Patmon*, 280 S.W.3d at 592 ("Subsequently, Hobbs and Steve Habeeb formed another [LLC] which was eventually assigned these leases. The company was started so that Hobbs would provide the leases and Habeeb would obtain the financing for the projects.")

256. See Douthwaite, *Profits and Their Recovery*, 15 VILLANOVA L. REV. 346, 370 (1970); GEORGE G. BOGERT AND GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES, § 543 at note 5 and accompanying text (Rev. 2nd Ed. 1993); D. DOBBS, HANDBOOK OF THE LAW OF REMEDIES 224 (1978).

257. See, e.g., BROMBERG & RIBSTEIN ON PARTNERSHIP, *supra* note 207 at § 6.07(i), text at note 166..

258. See BROMBERG & RIBSTEIN ON PARTNERSHIP, *supra* note 207 at § 6.07(i), text at note 159 (citations omitted); see also 1 F. HODGE O'NEAL AND ROBERT B. THOMPSON, O'NEAL AND THOMPSON'S OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 3.17 note 34 and accompanying text; see also *Steelvest*, 807 S.W.2d at 487 ("Accordingly, we determine, as a matter of law, that a breach of fiduciary duty is equivalent to fraud.")

259. See KY. REV. STAT. ANN. § 275.376(11)(d) as amended by 2010 Acts, ch. 133, § 44 (substituting "or" in place of "and").

260. 17 U.S. (4 Wheat) 518 (1819). In general, a "*Dartmouth College* provision" incorporates the state statute governing the business entity into the entity's governing document. For example, the provision added to KyULPA states: "A limited partnership governed by this subchapter is subject to any amendment or repeal of this subchapter."

261. See KY. REV. STAT. ANN. § 362.2-106(2), created by 2010 Acts, ch. 133, § 58. This provision supplements section 3 of the Kentucky Constitution, and brings KyULPA consistent with KyRUPA. See KY. REV. STAT. ANN. § 362.1-107.

262. See KY. REV. STAT. ANN. § 275.225(1)(c), created by 2010 Acts, ch. 133, § 34.

263. See *id.* § 275.225(2) as amended by 2010 Acts, ch. 133, § 34.

to the LLC. However, this rule may be modified in the Articles of Organization or a written operating agreement.<sup>264</sup>

The correction in KRS § 275.365(4) of “chooses” for “choices” corrects a typographical error that has existed since the adoption of the LLC Act in 1994.

Being in conflict with the Assumed Name statute, and specifically KRS § 365.015(8), the provision requiring that a corporation converting into an LLC cancel its assumed names has been deleted.<sup>265</sup>

In conformity with KyRUPA and KyULPA,<sup>266</sup> the LLC Act has been amended to exempt LLCs from the reach of KRS § 381.135.<sup>267</sup>

The LLC Act has been amended to authorize provisions in an operating agreement that affords rights to third parties,<sup>268</sup> and explicitly states that a

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264. See *id.* § 275.265(1) as amended by 2010 Acts, ch. 133, § 36. Accord DEL. CODE ANN. tit 6, § 18-702(a)(1) (providing a default rule of approval of all incumbent members of the LLC to the admission of assignee as a member but without the necessity of approval from “the member assigning the limited liability company interest”). With this revision, it remains the right of the incumbent members other than the assignor to determine whether they are willing to be members with the assignee. When this provision was originally drafted in 1994, it was provided that the unanimous consent of the members was required to admit an assignee as a member. That provision was amended in 1998, and that voting threshold was dropped to majority-in-interest. See KY. REV. STAT. ANN. § 275.265(1) as amended by 1998 Acts, ch. 341, § 36. With this modification, in certain scenarios, the members lost the ability to determine with whom they would be in business. For example, in an LLC owned 70% by a single member and with the balance of 30% spread amongst three otherwise equal members, the 70% owner could unilaterally assign a 10% interest to a third-party and then, exercising the majority vote, unilaterally cause the assignee to be admitted as a member of the company. With this revision, such an outcome, absent of provision to the contrary in the Articles of Organization or a written operating agreement, could not take place. This amendment to KRS § 275.265(1) introduces parallelism with KRS § 275.280(1)(c)2, which provides that the assignor member does not vote with respect to whether they will, consequent to the assignment of all of their interests in the LLC, be removed as a member. See also Thomas E. Rutledge, *Assigning Membership Interests: Consequences to the Assignor and Assignee*, 12 J. PASSTHROUGH ENTITIES 35 (July/Aug. 2009).

265. KY. REV. STAT. ANN. § 275.376 as amended by 2010 Acts, ch. 133, § 44.

266. See *id.* § 362.1-402(2); *id.* § 362.2-506(2).

267. See *id.* § 275.220(3), created by 2010 Acts, ch. 133, § 33; see also *id.* § 275.240(1) (members have no property right in property owned by LLC). When KRS § 275.240(1) is read in concert with *Mills v. Mills*, No. 2007-CA-000774-MR (Ky. App. Oct. 24, 2008), it is clear that KRS § 381.135, absent private ordering to the contrary, should not apply to LLCs. Pursuant to a written operating agreement an LLC may elect into the application of KRS § 381.135. Whether, absent this carve-out, the property of a farm LLC was ever subject to the partition provisions of KRS § 381.135 is open to question. By its terms, KRS § 381.135 is applicable to a “farm corporation or partnership.” The definition of a “corporation” may include a “company” (KY. REV. STAT. ANN. § 446.010(8)), the definition of a “company” may include a “person” (KY. REV. STAT. ANN. § 446.010(7)), and the definition of a “person” may include a “limited liability company.” *Id.* § 446.010(27). Whether such a tortured stroll through definitions is appropriate is open to debate. Further, KRS § 381.135(1)(a)1 was added in 1998, after the adoption of the LLC Act, and as that amendment did not include a reference to an LLC, including the LLC within the scope of the provision would violate principles of statutory construction. See also Thomas E. Rutledge and R. David Lester, *Recent Developments in the Valuation of Farm Properties*, 5 THE KY CPA 17, 17-18 (2010).

268. KY. REV. STAT. ANN. § 275.003(3), created by 2010 Acts, ch. 133, § 28. A provision of this nature could provide, for example, that for as long as a loan from a particular lender is

contractual obligation of good faith and fair dealing exists in each operating agreement.<sup>269</sup>

A new section has been added to the Business Corporation Act providing that a special meeting of the board of directors may be called by judicial order upon an application filed by at least one-third of the incumbent number of directors.<sup>270</sup>

The Nonprofit Corporation Act has been amended to make explicit that the member's right to inspect corporate records encompasses a right to copy those records<sup>271</sup> and that the right of inspection is not subject to limitation by the articles of incorporation or the bylaws.<sup>272</sup>

The filing fee for a foreign business trust applying for a certificate of authority has been set at \$100.<sup>273</sup>

A company does not "file" an annual report; that is the task of the Secretary of State after the submitted document is reviewed.<sup>274</sup> Rather, a company "delivers" an annual report for filing. "Deliver," as contrasted with "file," for a

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outstanding, the operating agreement may not be amended. While a covenant of this nature is often part of the loan documentation, its violation is typically an event of default under the note, and the lender's remedies are as set forth in the loan documentation. Contained in the operating agreement, the purported amendment is void *ab initio* (*id.* § 275.177), no default takes place, and the operating agreement remains in place.

269. *See id.* § 275.003(7), created by 2010 Acts, ch. 133, § 28. *Accord* KY. REV. STAT. ANN. § 362.1-404(4); *id.* § 362.2-305(2); and *id.* § 362.2-408(4). *See also* *Farmers Bank and Trust Co. of Georgetown, Kentucky v. Willmott Hardwoods, Inc.*, 171 S.W.3d 4, 11 (Ky. 2005) ("Within every contract there is an implied covenant of good faith and fair dealing, and contracts impose on the parties thereto a duty to do everything necessary to carry them out.").

270. *See* KY. REV. STAT. ANN. § 271B.8-205, created by 2010 Acts, ch. 133, § 2. While previously the Business Corporation Act provided a mechanism by which the shareholders could apply to the court to call a special meeting of the shareholders, there existed no equivalent provision with respect to calling a meeting of the directors. A similar provision has been added to the Nonprofit Corporation Act. *See id.* § 273.223(2), created by 2010 Acts, ch. 133, § 16.

271. *See id.* § 273.233 as amended by 2010 Acts, ch. 133, § 17. This amendment brings the Nonprofit Corporation Act into accord with the other acts, all of which provide that the right to inspect includes a right to copy. *See id.* § 271B.16-020(1) ("entitled to inspect and copy"); *id.* § 274.042 (adopting the rule of KRS § 271B.16-020); *id.* § 275.185 ("may . . . inspect and copy"); *id.* § 362.2-403(2) ("inspect and copy"); *id.* § 362.2-407(1) ("inspect and copy"). This addition to the statute is a clarification of the statutory formula; even without it the right of inspection carried with it the right to copy. *See, e.g.*, 18A AM.JUR.2D *Corporations* § 338; 5A FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2241 ("The right of a shareholder to make copies, abstracts and memoranda of documents, books and papers is an incident to the right of inspection, being recognized at common law.") (citations omitted); *Kaufman v. The Bryn Mawr Trust Co.*, 1981 WL 394 at \*4 (Pa. Com. P. 1981); *Brumley v. Jessup & Moore Paper Co.*, 77 A. 16 at 19-20 (Del. 1910); *Mickman v. American International Processing, LLC*, 2009 WL 2244608 (Del. Ch. July 28, 2009).

272. This language is drawn from KRS § 271B.16-020(4).

273. KY. REV. STAT. ANN. § 386.4426(3) as amended by 2010 Acts, ch. 133, § 73. That same \$100 fee applies each time the foreign business trust seeks to amend its certificate of authority. *Id.* § 386.4428(3) as amended by 2010 Acts, ch. 133, § 74.

274. *See also* Rutledge, *The 2007 Amendments*, *supra* note 1 at 253, note 163.

business organization's obligation to submit an annual report is now consistent across the various business entity acts.<sup>275</sup>

The provisions addressing annual reports filed by corporations have been revised to make explicit that the report must list the Secretary of the corporation; a tendered report that does not list a Secretary will be returned for correction and resubmission.<sup>276</sup> Foreign corporations not utilizing the MBCA formula (i.e., not requiring the designation of a "secretary") should identify the person having the custody of and capacity to authenticate the records of the corporation.<sup>277</sup>

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275. See, e.g., KY. REV. STAT. ANN. § 275.440 as amended by 2010 Acts, ch. 133, § 45; *id.* § 362.1-121 as amended by 2010 Acts, ch. 133, § 53; *id.* § 362.2-809 as amended by 2010 Acts, ch. 133, § 64; *id.* § 386.4444 as amended by 2010 Acts, ch. 133, § 75. Effective January 1, 2011 those provisions were superseded by KRS § 14A.6-050, created by 2010 Acts, ch. 151, § 34.

276. Every business corporation organized in the Commonwealth of Kentucky is required to have a "secretary," that being the title assigned to the person responsible "for preparing minutes of the directors' and shareholders' meetings and for authenticating records of the corporation." *Id.* § 271B.8-400(3) (requirement to have the officer); *id.* § 271B.1-400(23) (defining the "secretary" and referencing KY. REV. STAT. ANN. § 271B.8-400(3)). There exists no statutory requirement that a corporation have a president, a treasurer or any of the other typically seen officers. Each domestic and each foreign business corporation is required, on an annual basis, to file an annual report with the Secretary of State. *Id.* § 271B.16-220(1). Prior to the most recent amendments, the information required in the annual report included "The names and business addresses of its directors and principal officers." *Id.* § 271B.16-220(1)(d). With respect to a Kentucky corporation, those principal officers would include, and indeed may be limited to, the secretary. Effective January 1, 2011, the requirement to file an annual report was superseded as to its substance by KRS § 14A.6-010, created by 2010 Acts, ch. 151, § 11.

While the statute describes what appears to be substantially an inter se role for the secretary (i.e., the preparation and maintenance of director and shareholder minutes), it is clear from the definition of the office that the role of secretary also affects the relationship of the corporation to third parties through the capacity to authenticate corporate records (KY. REV. STAT. ANN. §§ 271B.1-400(23), 271B.8-400(3)), the provision that the secretary of the corporation services as an alternative agent for receipt of service of process (*Id.* § 271B.5-040(2)) and that they are as well the agent of the corporation for receipt of any other notice to be given it. *Id.* § 271B.1-410(4). In addition to that role, the corporate secretary has an important role in receiving service of process. When a corporation either has no registered agent or that agent cannot be with reasonable diligence served, the KyBCA provides that service of process may be made on "the secretary of the corporation at its principal office" by either registered or certified mail, return receipt requested. *Id.* § 271B.5-040(2). Rejecting annual reports that do not identify the corporate secretary:

- (1) Serves a prophylactic benefit in that it identifies corporations that are otherwise violating the Business Corporation Act by not having a secretary; and
- (2) Benefits third parties who may need to make service upon the corporate secretary when the registered agent is not able to be served or need to otherwise give notice to the corporation.

277. See MBCA § 1.40(20) (defining the person discharging the MBCA § 8.40(c) obligations as the "secretary"). For example, while a Tennessee corporation is not required to designate a "secretary," that not being a defined term (see TENN. CODE § 48-11-201), it is required to have an officer to whom is delegated "responsibility for preparing minutes of the directors' and shareholders' meetings and for authenticating records of the corporation." See TENN. CODE § 48-18-401(c).

The requirement that documents filed on behalf of a "private corporation" with a county clerk bear a scrivener block has been deleted.<sup>278</sup>

## XVII. L3Cs

A proposal that Kentucky authorize the formation of the so-called "low-profit limited liability company," or "L3C," was introduced to the 2010 Kentucky General Assembly.<sup>279</sup> In light of the significant controversy that exists with respect to the utility and effectiveness of the L3C structure,<sup>280</sup> S.B. 150 was amended by the House Judiciary Committee to provide that the interim

278. See KY. REV. STAT. ANN. § 382.335(1) as amended by 2010 Acts, ch. 133, § 72. The reasons for this deletion are twofold. Initially, what is a "private corporation" is less than clear, as such could, conceivably, include business organizations that are not incorporated. See *id.* § 446.010(8) (defining a "corporation" as including, based upon the context, a "company, partnership, joint stock company or association"). Second, KRS § 382.335 required that any documents relating to the "organization or dissolution of a private corporation" include a scrivener block. Early in 2009, the Secretary of State instituted an on-line filing system for, among other documents, corporate articles of incorporation. The Secretary of State's on-line system does not create a document that includes a scrivener block. Absent this amendment to KRS § 382.335, articles of incorporation filed on-line with the Secretary of State could not be filed with a county clerk. This is a problem as KRS § 271B.1-200(10) requires that Articles of Incorporation be filed with a county clerk of the county in which the registered office is maintained. Hence the amendment of KRS § 382.335.

279. H.B. 371, introduced February 3, 2010.

280. After its introduction, Representative Flood was kind enough to meet with the author to review concerns and criticism of the L3C. Examples of that criticism include: David Edward Spenard, *Panacea or Problem: A State Regulator's Perspective on the L3C Model*, 65 EXEMPT ORGANIZATION TAX REVIEW 131 (February, 2010); J. William Callison, *L3Cs: Useless Gadgets?*, 19 ABA BUSINESS LAW TODAY 55 (Nov./Dec. 2009); Carter G. Bishop, *The Low-Profit LLC (L3C): Program Related Investment by Proxy or Perversion?*, SUFFOLK UNIVERSITY LAW SCHOOL, LEGAL STUDIES RESEARCH PAPER SERIES, RESEARCH PAPER 10-09 (Feb. 12, 2010); David S. Chernoff, *L3Cs: Less Than Meets the Eye*, 21 TAXATION OF EXEMPTS 3 (2010); and J. William Callison and Allan W. Vestal, *The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures*, 35 VT. L. REV. 273 at 274 (2010):

But a funny thing happened on the way to the L3C party. Congress has not enacted L3C tax legislation, and substance and form have not aligned. Notwithstanding this setback, the L3C promoters have continued to lobby for state adoption and additional states have considered L3C legislation in 2010. In our view, without changes to federal PRI rules, the L3C construct has little or no value. Indeed, the existence of the state law form, without matching federal income tax substance, is dangerous since the ill-advised may assume value and use the Form. Therefore, unless and until tax law embraces the L3C, the form should be shelved. Further, the L3C concept is flawed as a matter of federal tax law, and it seems unlikely that the substance will be created to match the form. In our view, this is particularly the case with respect to "tranching" investment L3Cs due to the "private benefit" rule. Therefore, we conclude that the L3C is business entity device before its time, a time which likely will never come.

committee, working in concert with various stakeholders, would review the issue and prepare a recommendation for the 2011 General Assembly.<sup>281</sup>

#### XVIII. REVISIONS TO THE KENTUCKY UNIFORM PRINCIPAL AND INCOME ACT

At the time of its adoption, the Kentucky Uniform Principal and Income Act defined "entity" to include a "partnership," but did not reference the limited partnership. This was entirely appropriate as, at that point in time, every limited partnership was also a partnership.<sup>282</sup> However, with the adoption of KyRUPA and KyULPA, limited partnerships are now a distinct body and do not fall within the definition of a partnership.<sup>283</sup> For that reason, the Kentucky adoption of the Uniform Principal and Income Act has been amended to expressly include the "limited partnership" within the definition of "entity," thereby precluding an argument that the Act does not extend to limited partnerships.<sup>284</sup> That same section has been revised to include a statutory or business trust within the definition of an "entity."<sup>285</sup>

#### XIX. H.B. 220 AND THE READOPTION OF THE 2007 BUSINESS ENTITY LAW AMENDMENTS

In 2007, the Kentucky General Assembly, with House Bill ("H.B.") 334,<sup>286</sup> enacted a broad series of amendments across Kentucky's various business entity acts which were largely driven by an effort to rationalize and make consistent similar provisions across business entity laws.<sup>287</sup> On the last day of the session, the bill came up before the entire Senate, where it was amended on the Senate floor to include the substance of the provisions that previously appeared in 2007 H.B. 181.<sup>288</sup> As part of these additions, the Senate unfortunately amended the

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281. 2010 Acts, ch. 133, § 78 (not codified in Kentucky Revised Statutes). On April 23, 2010, the Committee on LLCs, Partnerships and Unincorporated Entities, Section of Business Law, American Bar Association, passed a resolution against further state adoption of L3C legislation. The proposed form of that resolution was set forth in XXVII PUBOGRAM 5 (April, 2010).

282. See KY. REV. STAT. ANN. §§ 362.175(2), 362.401(8); see also Allan W. Vestal and Thomas E. Rutledge, *The Uniform Limited Partnership Act (2001) Comes to Kentucky: An Owner's Manual*, 34 N. KY. L. REV. 411, 417 (2007).

283. This statement is correct as far as KyRUPA (KRS ch. 362.1) and KyULPA (KRS ch. 362.2) are related. However, the definition of "partnership" set forth at KRS § 446.010(24), which defines a "partnership" as including both a general and a limited partnership, could be applied notwithstanding KRS § 362.1-202(2) and its rejection of limited partnerships from its scope.

284. KY. REV. STAT. ANN. § 386.466(1).

285. KRS § 386.466(5) has been corrected by the Revision of the Statutes to add the "tax" that was inadvertently left out of the provision when it was otherwise adopted verbatim from the uniform act. This correction was made on September 9, 2008, and is included in KRS § 386.466 as amended by 2010 Acts, ch. 133, § 76. Additional 2010 revisions to the Kentucky Uniform Income and Principal Act were continued in H.B. 188 (2010 Acts, ch. 21). See also James E. Hargrove, *2010 Changes to the Kentucky Trust & Estate Practice*, 74 BENCH & BAR 5 (September 2010).

286. 2007 Acts, ch. 137.

287. See Rutledge, *The 2007 Amendments*, *supra* note 1 at 229.

288. 2007 Acts, ch. 137.

title of the bill to reflect that it was now “[a] bill dealing with post-secondary education,” notwithstanding that the bill governed business entity laws.<sup>289</sup> Ultimately, the House concurred in the amended bill, including with the now flawed title.<sup>290</sup>

In response to this mistake, the substantive provisions of 2007 H.B. 223 have been reenacted.<sup>291</sup> In addition to the reenactment of the substantive provisions of the 2007 legislation, the 2010 legislation makes clear that these provisions are to be applied as of June 26, 2007, which was the effective date of the 2007 legislation.<sup>292</sup>

## XX. CONCLUSION

The 2010 Amendments to Kentucky’s business entity laws were not as wide sweeping as the 2007 amendments. Nevertheless, they provide important clarification of many issues. Most importantly, the Amendments corrected the confusion that could have resulted from the Kentucky Court of Appeal’s ruling in *Barone v. Perkins*. Overall, the 2010 Amendments demonstrate the continued effort by Kentucky’s legislature and business bar to ensure that the Kentucky business acts remain current.

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289. *Id.*

290. *Id.*

291. 2010 Acts, ch. 51. This Act was introduced by Senator Jensen as S.B. 152. [www.lrc.ky.gov/record/10RS/SB152.htm](http://www.lrc.ky.gov/record/10RS/SB152.htm) It was assigned to the Senate Judiciary Committee on February 10, 2010 and hearings took place on February 11. *Id.* The bill was voted out of committee on a unanimous vote. *Id.* The bill came before the entire Senate on February 24, 2010 when it received the unanimous approval of all thirty-eight Senators. *Id.* On March 10, 2010, in concert with Senate Bills 150 and 151, the bill was approved by the House Judiciary Committee by a unanimous vote. The bill was voted out of the House on March 18 on a vote of 96 in favor and one against. *Id.* It was signed by Governor Beshear on March 30, 2010. *Id.*

292. 2010 Acts, ch. 51 §§ 180, 181 and 183. See also KY. OP. ATT’Y. GEN. 07-002 (2007).