LIMITED LIABILITY COMPANIES IN KENTUCKY
(UKCLE 2011)

Second Cumulative Supplement to Chapters 5, 6, 7 & 9

Basics of LLC Formation
Foreign LLCs
Limited Liability Company Operations
Dissolution of a Limited Liability Company

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Second Cumulative Supplement

(1) Page 86, footnote 30. Replace the footnote to read as follows:

Hereinafter the "BEFA." *See generally* 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).

(2) Page 89, footnote 57. Replace the footnote to read as follows:

KY. REV. STAT. ANN. § 14A.6-010(1). The name, the principal office address and the registered office/agent of the LLC may not be updated by amending the annual report. *See* KY. REV. STAT. ANN. § 14A.4-020 (distinct filing for change of registered office or agent); *id*. § 14A.5-010 (distinct filing for change of principal office address); and *id*. § 275.030(1)(a) (name of LLC changed by amending articles of organization).

(3) Page 89, footnote 58. Replace the footnote to read as follows:

See Rutledge and Tzanetos, *The Kentucky Business Entity Filing Act*, *supra* note 30 at 443; *see also* Rutledge and Booth, *The Limited Liability Company Act*, *supra* note 22 at 25, n. 106.

(4) Page 89, § [5.4]. Add the following to the end thereof:

Information in the annual report may be corrected if erroneous at the time of filing, in which case, other than for third-parties who have relied thereon to their detriment, the corrected filing will be deemed effective as of the filing of the original (and erroneous) annual report.[1]

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[1] KY. REV. STAT. ANN. § 14A.2-090. *See also Cass JV, LLC v. Host International, Inc*., 2012 WL 6569318 (W.D. Ky. Dec. 17, 2012) (Where a particular LLC was incorrectly listed as a member of an LLC, thereby precluding in the context of that suit diversity jurisdiction, an amendment to the annual report deleting the incorrectly-named member was given retroactive effect, resulting in denial of the plaintiff's motion to remand).

Second Cumulative Supplement

(1) Page 93, footnote 1. Replace the footnote to read as follows:

2010 Ky. Acts, ch. 151 (hereinafter the "BEFA"). *See generally* 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).

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(1) Page 105, footnote 19. Replace the footnote to read as follows:

KY. REV. STAT. ANN. § 275.300(4)(d); *see also* Thomas E. Rutledge, *The 2010 Amendments to Kentucky's Business Entity Laws*, 38 N. KY. L. REV. 38, 391 (2011).

(2) Page 106, footnote 21. Replace the footnote to read as follows:

See KY. REV. STAT. ANN. § 275.005 ("A [LLC] may be *organized under this chapter*.") (*emphasis* added); *id*. § 275.003(8) ("To the extent the articles of organization and the operating agreement do not otherwise provide, the Kentucky Limited Liability Company Act shall govern relations among the limited liability company, the members, the managers and the assignees."); *see also LJM Corp. v. Maysville Hotel Group, LLC*, No. 2004-CA-000120-MR (Ky. App. April 8, 2005) ("[A]ll existing laws, statutes and ordinances that are applicable are presumed to become part of the contract at the time and place of its making." *citing* 17A AM.JUR.2d *Contracts* § 371); 11 RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS BY SAMUEL WILLISTON § 30:19 (1999).

(3) Page 107, footnote 27. Replace the footnote to read as follows:

See KY. REV. STAT. ANN. § 275.003(5); *see also* Rutledge, *The 2010 Amendments*, *supra* note 19 at 397-99.

(4) Page 107. Create a new Section [7.1.11] to read as follows:

[7.1.11] The Absence of Grandfather Clauses in the Post-1994 Amendments to the LLC Act.

It should be recognized that even as the LLC Act has been repeatedly amended since its initial adoption, none of those amendments have incorporated a "grandfather" clause to the effect that the revised provision is applicable only to LLCs formed after that date. This absence of grandfathering the prior law will no doubt lead to disputes that, in future years, will be resolved by litigation.

> LLCs are creatures of contract, in this case the operating agreement. As a contract, the operating agreement incorporates the laws as it exists at the time the contract is entered into.[2]
>
> Under the Kentucky LLC Act, to the extent that the operating agreement does not set forth a contrary rule, the terms of the LLC Act apply;[3] in effect the LLC Act is the initial operating agreement of every LLC that may then be subject to modification by private ordering, subject, in certain instances, to a statute of frauds requirement.
>
> There is reserved to the Kentucky General Assembly the ability to amend the LLC Act,[4] thereby avoiding the rule of *Dartmouth College*. Statutes are not applied retroactively absent

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[2] *See, e.g., LJM Corp. v. Maysville Hotel Group, LLC*, No. 2004-CA-000120-MR (Ky. App. April 8, 2005) ("[A]ll existing laws, statutes and ordinances that are applicable are presumed to become part of the contract at the time and place of its making." *citing* 17A AM.JUR.2d *Contracts* § 371); 11 RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS BY SAMUEL WILLISTON § 30:19 (1999):

> When a contract expressly incorporates a statutory enactment by reference, that enactment becomes part of a contract for the indicated purposes just as though the words of that enactment were set out in full in the contract. Furthermore, parties to a contract or not otherwise subject to a statute may choose to incorporate parts of the statute to define their relationship without bringing the full force of the statute to bear. However the incorporation of applicable existing law into a contract does not require a delivered expression by the parties. Except where a contrary intention is evident, the parties to a contract – including the government, in a contract between the government and a private party – are presumed or deemed to have contracted with reference to existing principles of law. An intention not to adopt existing law may be manifested by a contractual provision to such effect, and in most jurisdictions, the intent to modify applicable law by contract is effective only where it is expressly exercised by valid contractual stipulation.
>
> Under this presumption of incorporation, valid applicable laws existing at the time of the making of a contract entered into and form a part of the contract as fully as if expressly incorporated in the contract. Thus, contractual language must be interpreted in light of existing law, the provisions of which are regarded as implied terms of the contract, regardless of whether the agreement refers to the governing law. This principle applies to the common law in effect in the jurisdiction, as well as to constitutional provisions, statutes, ordinances and regulations, including provisions which affect the validity, construction, operation, effect, obligations, performance, termination, discharge and enforcement of the contract (citations omitted).

[3] KY. REV. STAT. ANN. § 275.003(8).

[4] KY. CONST. § 3 ("and every grant of a franchise, privilege or exemption, shall remain subject to revocation, alteration or amended.").

the General Assembly's express intent to do so.[5] While the General Assembly retains the power to amend the LLC Act, the act itself limits the degree to which existing contracts may be altered by those amendments.[6] With respect to those subsequent changes, as stated by a leading authority:

> Thus, as a rule of construction, changes in the law subsequent to the execution of a contract are not deemed to become a part of *([the] – sic)* unless its language clearly indicates such to have been *([the] – sic)* intention of *([the] – sic)* parties.[7]

And there arises the question; if an operating agreement is entered into on Monday that is silent as to Issue A, and on Wednesday the General Assembly alters (even reverses) the statutory default rule as to Issue A, and the factual situation dealing with Issue A arises on Friday, is it the law of Monday or Wednesday that will control? Put in perhaps more concrete terms, assume that a LLC was organized in 1996; its written operating is silent as to a member's right to withdraw from the company and receive a liquidating distribution. Under the statutory default rule in effect at that time, any member could withdraw on thirty days' prior written notice and receive a liquidating distribution of the "fair value" of their interest in the company. Now, in 2013, a member decides to withdraw from the company and expects a distribution in the amount of the fair value of his interest therein. Of course, beginning in 1998, the statute as to the right to withdraw has been repeatedly amended, but under none of those amendments was there preserved the right to a liquidating distribution upon dissociation.

On the position that no liquidating distribution is appropriate, it may be argued that in consequence of the General Assembly's ability, on an ongoing basis, to amend the act, the rights of a member from time to time are as dictated by the General Assembly, and that no contractual right to a liquidating distribution arose until the resignation, so no vested rights under a contract had been infringed. From the opposing position, it will be argued that the LLC Act, as it existed at the time of the operating agreement

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[5] KY. REV. STAT. ANN. § 446.080(3).

[6] *See* KY. REV. STAT. ANN. § 275.003(1) (an amendment of the LLC Act "shall not be construed to impair the obligations of any contract existing" when the amendment becomes effective.).

[7] WILLISTON ON CONTRACTS at § 30:23.

was adopted, was incorporated into the agreement, and on that basis his right to a liquidating distribution upon dissociation continues to exist and is enforceable.[8]

(5) Page 113, footnote 82. Replace the footnote to read as follows:

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); and Rutledge, *Chapman v. Regional Radiology Associates, PLLC: A Case Study in the Consequences of Resignation*, 100 KY. L.J. ONLINE 15 (2011).

(6) Page 119, footnote 82. Replace the footnote to read as follows:

A bifurcation of the standard of care and the standard of culpability is set forth in the Kentucky Business Corporation Act, wherein the directors' 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*, 369 S.W.3d 39, 2010 Ky. App. LEXIS 79, 2010 WL 1627972 (Ky. App. Apr. 23, 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.")

(7) Page 121, § [7.7.2]. Add the following new paragraph to the end of § [7.7.2]:

It is important, when considering KRS § 275.170(2) and its statutory formula for the duty of loyalty, to contrast it with KRS § 275.170(1) and its formula for the duty of care/culpability, in assessing to whom the duty is owed. KRS § 275.170(1) provides that the duty is owed to both the limited liability company and the other members. In contrast, the duty of loyalty as set forth in KRS § 275.170(2) refers only to the limited liability company; there is no suggestion that the duty of loyalty is owed individually to the

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[8] *See also Sage v. Radiology and Diagnostic Services, L.L.C.*, 831 So.2d 1053 (La. App. 2002) (notwithstanding subsequent amendment of governing LLC Act, member of LLC entitled to redemption upon withdrawal as provided for in LLC Act at time of the LLC's formation).

other members. A material consequence to this distinction[9] is that suits brought alleging a breach of the duty of loyalty may proceed only in the name and for the benefit of the LLC and not on behalf of any individual member.[10]

(8) Page 123, footnote 134. Replace the footnote to read as follows:

See, e.g., *Fastenal Company v. Crawford*, 609 F. Supp. 2d 650, 665 (E.D. Ky. 2009) ("In order to prevail on a claim for breach of fiduciary duty, the plaintiff must prove: (1) the defendant owes a fiduciary duty to the plaintiff….") (*citing Sparke v. Re/Max Allstar Realty, Inc*., 55 S.W.3d 343, 348 n.15 (Ky. Ct. App. 2000) and *Biggs v. Eaton Sales, Inc*., 2011 Ky. App. LEXIS 91, 2011 WL 1901793, *10 (Ky. Ct. App. 2011) ("As our court has noted, '[i]f no duty is owed by the defendant to the plaintiff, there can be no breach thereof, and therefore no actionable negligence.'" (quoting *Ashcraft v. Peoples Liberty Bank & Trust Co., Inc*., 724 S.W.2d 228, 229 (Ky. Ct. App. 1986)). *See also In re the Heritage Org., L.L.C.*, No. 04-35574-BJH-11, 2008 WL 5215688, at *18 (Bankr. N.D. Tex. Dec. 12, 2008) ("Without a duty, there can be no breach of duty or resulting harm."); *Turkey Creek, L.L.C. v. Rosania*, 953 P.2d 1306, 1312 (Colo. Ct. App. 1998) ("Before there can be a breach of a fiduciary duty, a fiduciary relationship or a confidential relationship must exist.") (citing *Vikell Investors Pac., Inc. v. Kip Hampden, Ltd*., 946 P.2d 589 (Colo. Ct. App. 1997)).

(9) Page 129, footnote 166. Replace the footnote to read as follows:

See KY. REV. STAT. ANN. § 275.285(3); *see also Chapman v. Regional Radiology Associates, PLLC*, 2011 Ky. App. Unpub. LEXIS 251 (Ky. Ct. App. Mar. 25, 2010), and Rutledge, *Chapman v. Regional Radiology Associates, PLLC: A Case Study in the Consequences of Resignation*, 100 KY. L.J. ONLINE 15 (2011).

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[9] These provisions, based originally upon § 402 of the Prototype Limited Liability Company Act, track the distinction made therein.

[10] *See also Chou v. Chilton*, 2012 WL 6526184 (Ky. App. Nov. 16, 2012). Therein, an individual member of an LLC, Chou, brought suit against the other members of the LLC, alleging that the defendants had diverted from the LLC certain opportunities and otherwise violated the duty of loyalty. The trial court dismissed those claims based upon the lack of standing by Chou to assert them for his individual benefit (the LLC was itself not named as a party in the action), which determination was in turn affirmed by the Kentucky Court of Appeals. As a point of disclosure, this author served as the defendant's expert.

(10) Page 129, footnote 167. Replace the footnote to read as follows:

See KY. REV. STAT. ANN. §§ 275.285(3)(a), (4); *see also* Rutledge, *The 2010 Amendments*, *supra* note 19 at 399-403.

(11) Page 130, footnote 171. Replace the footnote to read as follows:

KY. REV. STAT. ANN. § 275.225. *See also* Rutledge, *The 2010 Amendments*, *supra* note 19 at 415.

(12) Page 131, footnote 184. Replace the footnote to read as follows:

See also KY. REV. STAT. ANN. § 275.220(3); Rutledge, *The 2010 Amendments*, *supra* note 19 at 416. In *Gattoni v. Zaccaro*, 1997 WL 139410 (Conn. Super. Ct. March 7, 1997), the court reviewed a situation in which the title owner to certain real property was an LLC. There was a falling out between the members of the LLC. In rejecting a claim for, *inter alia*, partition of the property, the court cited the provision parallel to KRS § 275.240 and held that the plaintiff had no interest in the real estate of the LLC which would entitle him to bring a partition action.

(13) Page 133, footnote 196. Replace the footnote to read as follows:

See KY. REV. STAT. ANN. § 275.150(3); *see also* Rutledge, *The 2010 Amendments*, *supra* note 19 at 387-88.

(14) Pages 133-34. Replace the entirety of § 7.13.5 as follows:

[7.13.5] Piercing the LLC Veil

No published decision of a Kentucky appellate court has addressed the factors to be considered in piercing the veil of an LLC. In an unpublished trial court ruling written by now Justice Abramson of the Kentucky Supreme Court, it was stated:

> While it is true that the foregoing represents the law with respect to the liability of *corporate* officers and shareholders, equity and fairness required that those same theories of liability [piercing and personal responsibility for personally committed torts] should extend to managers and member of limited liability companies as well.[11]

[11] *See Fabing v. E Concepts, LLC*, Jeff. Cir. Ct. (Div. 3) No. 01-CI-06835, Order Granting Plaintiff's Motion for Partial Summary Judgment entered June 9, 2003 (*emphasis* in original).

In *Rednour Properties, LLC v. Spangler Roofing Services, LLC*,[12] the Court of Appeals, without setting forth any analytic framework to its decision, affirmed a ruling of the trial court imposing personal liability for the debts and obligations of the LLC upon its sole member for reasons that included the fact that he was the sole member and the registered agent of the company and that the company had been organized for tax purposes. An expansive criticism of the failings of this decision has been published elsewhere.[13]

On February 23, 2012, the Kentucky Supreme Court issued its tour-de-force opinion (written by Justice Abramson) updating Kentucky's law on piercing the corporate veil, *Inter-Tel Technologies, Inc., v. Linn Station Properties, LLC*.[14] Relying in part upon Professor Stephen Presser's treatise PIERCING THE CORPORATE VEIL, the Supreme Court began its analysis by a general review of the development of piercing law nationwide, and from there focusing upon "Kentucky's seminal and leading case on the subject," namely *White v. Winchester Land Development.*[15] From there it reviewed in detail the *White* decision and its analytic antecedent, namely Professor Campbell's article *Limited Liability for Corporate Shareholders: Myth or Matter – of Fact*,[16] both reciting the alternative (although acknowledged to be overlapping) theories of instrumentality, alter-ego and equity as alternative basis for piercing the veil. However, where *White* focused upon a discreet list of five factors under the equity formula, the Supreme Court has expanded that list to eleven, namely:

a) Does the parent own all or most of stock of the subsidiary?

b) Do the parent and subsidiary corporations have common directors or officers?

c) Does the parent corporation finance the subsidiary?

d) Did the parent corporation subscribe to all of the capital stock of the subsidiary or otherwise cause its incorporation?

e) Does the subsidiary have grossly inadequate capital?

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[12] No. 2009-CA-001159-MR, 2011 WL 2535330 (Ky. Ct. App. 2011). This opinion was originally designated "To Be Published." On April 18, 2012 the Kentucky Supreme Court both denied discretionary review and ordered that the opinion of the Court of Appeals not be published.

[13] *See* Rutledge, *Rednour Properties, LLC v. Spangler Roof Services, LLC – A Rant in Three Parts*, Kentuckybusinessentitylaw.blogspot.com (Nov. 7, 8 & 9, 2011).

[14] 360 S.W.3d 152 (Ky. 2012).

[15] 584 S.W.2d 56 (Ky. App. 1979).

[16] 63 KY. L.J. 23 (1975).

f) Does the parent pay the salaries and other expenses or losses of the subsidiary?

g) Does the subsidiary do no business except with the parent or does the subsidiary have no assets except those conveyed to it by the parent?

h) Is the subsidiary described by the parent (in papers or statements) as a department or division of the parent or is the business or financial responsibility of the subsidiary referred to as the parent corporation's own?

i) Does the parent use the property of the subsidiary as its own?

j) Do the directors or executives fail to act independently in the interest of the subsidiary, and do they instead take orders from the parent, and act in the parent's interest?

k) Are the formal legal requirements of the subsidiary not observed?[17]

The Court drew particular attention to "grossly inadequate capitalization, egregious failure to observe legal formalities and disregard of distinctions between parent and subsidiary, and a high degree of control by the parent over the subsidiary's operations and decisions, particularly those of a day-to-day nature," stating "We believe that these are the most critical factors…."[18] In further clarification of *White*, the Supreme Court made express that while either "sanctioning fraud or promoting injustice" is necessary for piercing, it remains the rule that "the injustice must be something beyond the mere inability to collect a debt from the corporation."[19] Still, proof or evidence of actual fraud is not required.[20]

In *Inter-Tel*, the Court was focused upon the veil between affiliated (subsidiary to parent and ultimate subsidiary to grandparent) corporations; it remains to be seen how the opinion is applied (a) as to a claim to pierce a business organization to reach a natural person and (b) to a claim to pierce a business organization other than a corporation.

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[17] 360 S.W.3d at 163-64. This list of factors was drawn from FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS: LIABILITY OF A PARENT CORPORATION FOR THE OBLIGATION OF ITS SUBSIDIARIES (1931).

[18] 360 S.W.3d at 164.

[19] 360 S.W.3d at 164.

[20] 360 S.W.3d at 164-65.

The 2012 Kentucky General Assembly, responding to the *Rednour* decision, amended the LLC Act to stipulate that the LLC being a single member LLC is not of itself a basis for piercing.[21]

(14) Page 135. Replace the entirety of § 7.15 as follows:

[7.15] Series LLCs

Several states provide that an LLC may be organized with "series."[22] To date Kentucky does not provide for series in its LLC Act; series are provided for in the Kentucky Uniform Statutory Trust Act (2012).[23] Whether the series liability shield of a foreign LLC with series would be respected in Kentucky is an open question.[24]

(15) Pages 135-138. Replace the entirety of § 7.16 as follows:

[7.16] Assignment of LLC Interests

An interest in an LLC is personal property, and unless the operating agreement provides otherwise, an LLC interest, in whole or part, is assignable.[25] A 2007 addition to the LLC Act serves to preempt KRS §§ 355.9-406 and 355.9-408, which may be interpreted to preempt limitations upon pledges of LLC membership interests contained in a written operating agreement.[26] The interest may be evidenced by a certificate, which itself may provide for the assignment or transfer of the interest represented.[27]

However, while the interest is freely assignable, the rights of management incident to that interest are not freely transferable. Therefore, while a member may unilaterally transfer the prospective interest in distributions made by the LLC (*i.e.*, the "economic rights"), a member

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[21] *See* KY. REV. STAT. ANN. § 275.150(1) as amended by 2012 Ky. Acts, ch. 81, § 105; *see also* Rutledge, *The 2012 Amendments to Kentucky's Business Entity Statutes*, 101 KY. L.J. ONLINE 1, 3 (2012-13).

[22] *See generally* Thomas E. Rutledge, *Again, For the Want of a Theory: The Challenge of the "Series" to Business Organization Law*, 46 AMER. BUS. L.J. 311 (2009).

[23] *See* 2012 Ky. Acts, ch. 81, §§ 1-76, as codified in KRS chapter 386A; *see also* Thomas E. Rutledge, *The Kentucky Uniform Statutory Trust Act (2012): A Review*, __ NORTHERN KENTUCKY LAW REVIEW __ (2012-13) (*forthcoming*). For further commentary on series, *see, e.g.*, Rutledge, *Again, For the Want of a Theory: The Challenge of the "Series" to Business Organization Law*, 46 AM. BUS. L. J. 311 (2009); and Rutledge, *The Man Who Tells You He Understands Series Will Lie To You About Other Things As Well*, __ J. PASSTHROUGH ENTITIES __ (Mar./Apr. 2013) (*forthcoming*).

[24] *See* Rutledge, *Again, For the Want of A Theory*, *supra note* 16 at 328-38.

[25] KY. REV. STAT. ANN. § 275.255(1)(a). *See generally* Rutledge, *Assigning Membership Interests*, *supra* note 168.

[26] KY. REV. STAT. ANN. § 275.255(4). *See also* Rutledge, *The 2007 Amendments*, *supra* note 36 at 249.

[27] KY. REV. STAT. ANN. § 275.255(2).

may not unilaterally transfer the right to take part in the direction and management of the LLC (*i.e.*, the "management rights").[28] As detailed in KRS § 275.255(1)(e):

> An assignment … shall not … entitle the assignee to participate in the management and affairs of the [LLC] or to become or exercise any rights of a member ….

The management rights include the right to:

- participate, either directly or by election, in management;
- inspect the records of the LLC;
- vote on the admission or replacement of additional members; and
- vote on the voluntary dissolution or continuation of the business after a dissolution event.

A member who has made an assignment of the economic rights of membership remains a member, exercising only the management rights of membership, until such time as the assignee becomes a member or the assignor member is removed.[29] A member who assigns all of their economic interest in an LLC, those being the only rights that may be unilaterally assigned, may be dissociated and shall cease to be a member upon the consent of a majority-in-interest of the non-assigning members.[30] A 2012 revision made to the LLC Act, namely the addition of "that they may unilaterally transfer," addresses the argument that not "all" of a member's interest has been conveyed, and therefore he cannot be dissociated, because the non-transferrable rights to participate in management have not been transferred.[31] Ergo, when a member has transferred all of his economic interest in a venture, he is thereafter subject to dissociation by the other members. Until that dissociation (or in a member-managed LLC a voluntary resignation[32]) the assignor remains bound by all fiduciary and other obligations applicable absent the assignment. An assignment of an LLC interest does not dissolve the LLC.[33]

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28 KY. REV. STAT. ANN. §§ 275.255(1)(b)-(c).

29 KY. REV. STAT. ANN. § 275.255(1)(d).

30 *See* KY. REV. STAT. ANN. § 275.280(1)(c)2.

31 *See* 2012 Ky. Acts, ch. 81, § 109, amending KRS § 275.280(1)(c)2.

32 *See supra* Section [7.3.8].

33 KY. REV. STAT. ANN. § 275.255(1)(c).

An assignee who has not yet received a transfer of the management rights of membership has no liability as a member consequent to the assignment, and the assignment does not release the assignor of any liability they incurred while a member.[34]

The rights of an assignee are very limited when compared to those of a member. Unlike members, who typically hold management rights, an assignee does not have inspection rights or other related information rights,[35] nor a right to participate in management[36] even with respect to modification of the underlying operating agreement when the modifications have a negative effect on the assignee.[37] Finally, the assignee or transferee is typically owed neither fiduciary obligations nor obligations of good faith or fair dealing.[38]

Unless the operating agreement provides otherwise, a pledge, granting a security interest in, lien against or encumbrance of an LLC interest does not constitute an assignment and does not terminate or impair the rights of the member.[39] Rather, they entitle the assignee to receive, to the extent made, the distributions and other economic rights to which the assignor would be entitled.[40]

Permitting the bifurcation of the rights of membership between management rights and economic rights may lead to a situation in which the ownership of an LLC is divided into three camps: members with both economic rights and management rights; transferor members who retain only management rights but have no economic rights; and transferees who have economic rights but no management rights in the LLC. While the absence of management rights in an

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[34] KY. REV. STAT. ANN. §§ 275.255(1)(e)-(f).

[35] *See* KY. REV. STAT. ANN. § 275.185(2) (inspection rights are available to "members"); *id.* § 275.185(3) (obligation to disclose information to "members"); and *id.* § 275.255(1)(c) (assignee does not have the rights of a member).

[36] *See* KY. REV. STAT. ANN. § 275.255(1)(c) (providing in part "An assignment of a [LLC] interest shall not...entitle the assignee to participate in the management and affairs of the [LLC] or to become or exercise any rights of a member other than the right to receive distributions pursuant to subsection (1)(b) of this section.")

[37] *See, e.g.*, *Bauer v. The Blomfield Co.*, 849 P.2d 1365 (Alaska 1993) (assignee of partnership interest not owed obligations of good faith and fair dealing); *Bailey v. Fish & Neave*, 868 N.E.2d 956, 837 N.Y.S.2d 600 (N.Y. Ct. App. 2007) (amendment of partnership agreement altering post-withdrawal benefits to already withdrawn partners permitted). *See also* 1 LARRY E. RIBSTEIN AND ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 7.5 (2nd ed. December 2012), notes 19-20 and accompanying text.

[38] *Bayside Petroleum, Inc. v. Whitmar Exploration Co.*, 1997 WL 34690262 (D. Okla. 1997) ("no fiduciary duty" is owed the assignee of a partner); *Haynes v. B&B Realty Group, LLC*, 633 S.E.2d 691 (N.C. 2006) (no fiduciary duties owed to transferee of LLC interest); *Landskroner v. Landskroner*, 797 N.E.2d 1002, 1014 (Ohio Ct. App. 2003) (fiduciary duties are not owed to former member of LLC); Thomas E. Rutledge, Carter G. Bishop & Thomas Earl Geu, *No Cause for Alarm: Foreclosure and Dissolution Rights of a Member's Creditor*, 21 PROBATE & PROPERTY 35 (May-June 2007).

[39] KY. REV. STAT. ANN. § 275.255(3).

[40] KY. REV. STAT. ANN. § 275.255(1)(b).

assignee[41] is a necessary element of the desired *in delectus personae* aspect of the LLC,[42] problems may arise in permitting the assignor to continue to exercise management rights. Having no further interest in the economics of the venture, the assignor has little incentive to participate or, for their own account, seek to maximize the success of the LLC. If the assignor has agreed to exercise management authority on behalf of or in accordance with instructions from the assignee, then *in delectus personae* is violated and management is being exercised, albeit indirectly, by one not admitted as a member.[43] In order to avoid that eventuality the Act permits the incumbent members to dissociate the assignor, whereupon the assignor ceases to be a member and to have any voice in the LLC's management.[44] Upon the dissociation of the assignor *in delectus personae* is recovered, the LLC being comprised of assignees with no right to participate in management and members with interests in both the management and the economics of the LLC.

(16) Page 138, footnote 235. Replace the footnote to read as follows:

See KY. REV. STAT. ANN. § 275.265(1); *see also* Rutledge, *The 2010 Amendments, supra* note 19 at 415-16.

(17) Page 138. Create a new Section [7.16.1] to read as follows:

[7.16.1] Existing Ambiguities in the LLC Act on the Assignment of an LLC Interest.

The LLC Act is clear that absent either a contrary provisions in a written operating agreement of the consent of a majority-in-interest of the members other than the transferor, the transferee of an LLC interest may not exercise the management rights of a member.[45] Upon the assignment of all economic interest in the venture the assignee continues as a member with management rights, but the assignor member may be dissociated from the LLC by the vote of a majority-in-interest of the other members, whereupon the assignor member loses the prospective right to participate in management.

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[41] KY. REV. STAT. ANN. § 275.255(1)(c).

[42] *See, e.g.*, KY. REV. STAT. ANN. § 275.265(1); *id*. § 275.275(1)(a).

[43] *See also* Thomas E. Rutledge, *In Delectus Personae and Proxies*, 14 J. PASSTHROUGH ENTITIES 43 (July/Aug. 2011).

[44] KY. REV. STAT. ANN. § 275.280(1)(c)2. *Accord id*. § 362.1-601(4)(b) (expulsion of a partner who has transferred all or substantially all of his transferrable interest); *id*. § 362.2-603(4)(b) (same); and *id*. § 362.2-601(2)(d)2 (same).

[45] *See* KY. REV. STAT. ANN. § 275.265(1). In 2010, it was made express that the transferor member does not vote on the admission of the transferee as a member. *See* 2010 Ky. Acts, ch. 133, § 36.

At least a quartet of ambiguities exist under the statutory formula:

- if an assignment is to one who is already a member, does that member come into economic and voting rights vis-à-vis the transferred interest?;

- what is "all" of an LLC interest?;

- on what basis is the vote of a partial assignor determined?; and

- on what basis are the distributional, allocation and voting rights of a transferee determined?

With respect to the assignment of an interest to one who is already a member, the statute simple does not address that situation. In the absence of private ordering to the contrary, the assignor should step into full rights of membership vis-à-vis those interests, but there is as of yet no specific provision in the Act to that effect.[46]

The statute as enacted speaks to the transfer by a member of "all" of his or her interest in the LLC even as, while the economic incidents of ownership are freely transferable,[47] the management rights are not.[48] Upon the transfer of all of the interest in the LLC the remaining members may dissociate the transferor member.[49] If, however, there was no transfer of "all" then no right to dissociate arises. Only by reading "all" to refer to the transferable economic rights does the statute make any sense, otherwise KRS § 275.280(1)(c)2 would never be applicable. Still, at least one trial court was confused by the point, holding there had been no transfer of "all" as the transferor retained the non-transferable management rights. In response thereto the statute was revised to provide, *inter alia*, that upon the transfer of all rights that are unilaterally alienable, the transferor member is subject to dissociation.[50]

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[46] *See also Blythe v. Bell*, 2012 NCBC 60 (2012).

[47] *See* KY. REV. STAT. ANN. § 275.255(1)(b).

[48] *See* KY. REV. STAT. ANN. § 275.255(1)(c). Unlike the modern partnership and limited partnership acts, the LLC Act does not have a defined term for what is under these statutes a "transferable interest" distinct from the "interest in the partnership." *See* KY. REV. STAT. ANN. § 362.1-101(13); *id.* § 362.1-502; *id.* § 362.2- 102(26); and *id.* § 362.2-702(1).

[49] *See* KY. REV. STAT. ANN. § 275.280(1)(c)2.

[50] *See* KY. REV. STAT. ANN. § 280(1)(c)2 as amended by 2012 Ky. Acts, ch. 81, § 109.

Assume a simple LLC comprised of members A, B and C. Each contributed $1,000 for a one-third interest in the LLC. In accordance with the LLC Act voting, allocation and distribution rights are in accordance with capital contributed and not returned. B then unilaterally conveys 50% of his limited liability company interest to D, but D is not admitted to the LLC as a member. It is clear that D Is entitled to 50% of the distribution that A, but for the transfer, would have received. As such, were the LLC dissolved immediately after the transfer its net proceeds would go as follows:

A	33.33%
B	16.66%
C	33.33%
D	16.66%

But the LLC does not dissolve. Rather, a vote of the members needs to be taken; the matter under consideration requires the consent of a majority-in-interest of the members. Assume that A and B are in favor of the transaction while C is opposed. D's view does not matter; D is an assignee who has no right to participate in the LLC's management. If B, even after the conveyance of half of his economic rights in the LLC continues to vote with respect to all of his capital contribution made and not returned, then the motion passes with the approval of 66.66% of the LLC interests. Alternatively, if B votes only in proportion to his capital contribution that he has not, on at least a beneficial basis, transferred, then the motion (a) will pass (49.99 out of 83.32 in favor) if the capital base is reduced by the amount that would be distributed to D or (b) will fail (49.99 out of 100 in favor) if the capital base is not reduced by the amount that would be distributed to D. The statute does not tell you which is the correct answer.

Continuing with the above example of A, B and C with D as a transferee, assume now that A and C have now approved D's admission as a member. While they executed a dated written instrument admitting D as a member,[51] they did nothing more than that. It now comes time for a member vote. On what basis is D's vote determined? He will assert a 16.66% vote, being one half of what was previously enjoyed by B. C, for whatever reason, insists on strict application of the LLC Act as written, and it says that D's voting rights are in proportion to D's capital contributed to and not

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[51] *See also* KY. REV. STAT. ANN. § 275.265(1) (unless a different rule is set forth in a written operating agreement, the consent to the admission of an assignee as a member must be in a writing signed and dated by the consenting members).

returned by the LLC.[52] D has never made a capital contribution to the LLC. While the Code may provide that upon the transfer of an interest in a partnership the transferee succeeds to the transferor's capital account,[53] there is no provision of the LLC Act which provides "upon the transfer of an LLC interest and the admission of the transferee as a member, the transferee succeeds to that portion of the capital contributed by the transferor." This LLC's operating agreement, while written, is silent as to the point. Again, the LLC Act is silent as to how the point is to be resolved.

(18) Page 140, footnote 247. Replace the footnote to read as follows:

See 2010 Ky. Acts, ch. 133, § 35; *see also* Thomas E. Rutledge, *The 2010 Amendments*, *supra* note 19 at 396-97.

(19) Page 141, Section [7.18]. Insert the following before what is now the penultimate paragraph of the section:

It is expressly provided that the LLC is not a necessary party to an action seeking a charging order against a judgment-debtor.[54]

(20) Page 143, Section [7.20]. Insert the following as a new second paragraph of Section [7.20]:

Provisions added in 2012 provide that members and managers of an LLC are deemed to have consented to the jurisdiction of the Kentucky courts with respect to any suit brought by or on behalf of the organization.[55] While not intended to limit any existing basis for asserting jurisdiction, these provisions preclude, for example, the argument that a manager of a Kentucky LLC who resides in a foreign jurisdiction and who has never attended a meeting or otherwise acted in Kentucky is exempt from the jurisdiction of Kentucky's courts when an action for violation of the manager's fiduciary obligations to the LLC is filed against that manager.[56]

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[52] *See* KY. REV. STAT. ANN. § 275.175(3).

[53] *See* TREAS. REG. § 1.704-1(b)(2)(iv)(l).

[54] KY. REV. STAT. ANN. § 275.260(6). *See also Bank of America, N.A. v. Freed*, ____ N.E.2d ____, 2012 WL 6725894 (Ill. App. I Dist., Dec. 28, 2012).

[55] *See* KY. REV. STAT. ANN. § 275.335(2), created by 2012 Ky. Acts, ch. 81, § 112.

[56] A similar provision exists in Delaware. *See* DEL. CODE ANN. tit. 10, § 3114 (2010).

(21) Page 143, footnote 274. Replace the footnote to read as follows:

> KY. REV. STAT. ANN. § 275.335(2). *See also* James Burkhard, *Resolving LLC Member Disputes in Connecticut, Massachusetts, Pennsylvania, Wisconsin, and the Other States That Enacted the Prototype LLC Act*, 67 BUS. LAW. 405 (Feb. 2012).

(22) Page 143. Insert the following as a new paragraph between what are now the first and second paragraphs of Section [7.21]:

> It needs to be recognized that KRS § 275.335 is not a derivative action provision. Rather, it defines alternative means by which the LLC may be authorized to itself bring an action. Ergo, even where an LLC is manager-managed, the decision to bring an action may still be brought by the members, and when that action is initiated by either the members or the managers, this provision sets forth the required thresholds for consent (absent contrary private ordering). The LLC Act itself is silent as to derivative actions.[57] The statute having not modified or limited any of the rules that have arisen in equity with respect to derivative actions, they will be applicable to any derivative action that might be brought.[58]

(21) Page 144, footnote 276. Replace the footnote to read as follows:

> *See also* Rutledge, *The 2010 Amendments*, *supra* note 19 at 389-90.

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[57] *See also* PROTOTYPE LIMITED LIABILITY COMPANY ACT, § 1102, comment.

[58] *See also* Rutledge, *Some of the Who, To Whom, When, To Do What and Not To Do What of Fiduciary Obligations*, available on SSRN.

Second Cumulative Supplement

(1) Page 162, § 8.15, first paragraph. Replace the first paragraph of § 8.15 to read as follows:

> In 2007, the LLC Act was amended to enable LLCs to engage in share exchanges with corporations.[90] It must be recognized that the transaction authorized works only in one direction, namely of that of the LLC acquiring the shares. The corporation whose shares are at issue may be either domestic or foreign provided that, in the instance of a foreign corporation, the share exchange is permitted under the laws of it jurisdiction of incorporation.[59]
>
> There does not exist a statutory transaction pursuant to which a corporation may acquire the limited liability interests in a LLC. This is not to say, however, that a corporation and a LLC are precluded from engaging in a share exchange in which the corporation is the acquiring party. Rather, such a transaction will be simply pursuant to private contract enforceable in accordance with the terms of that agreement. There will exist no statutory overlay as to either the requirements for the approval of the transaction, its legal effect amongst the parties thereto or its effect as to third parties.

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[59] KY. REV. STAT. ANN. § 275.500(1).

Second Cumulative Supplement

(1) Page 171, footnote 44. Replace the footnote to read as follows:

> KY. REV. STAT. ANN. § 275.300(3)(d); *see also* Rutledge, *The 2010 Amendments to Kentucky's Business Entity Laws*, 38 N. KY. L. REV. 383, 391-92 (2011).

(2) Pages 172-73. Replace the entirety of § 9.4.1 to read as follows:

[9.4.1] Agency Power of Members or Managers After Dissolution

During the winding up phase, a member or manager of the LLC may bind the LLC in the course of transactions appropriate to the winding up of its affairs and for such other purposes as are authorized by the members or managers.[60] With respect to third parties without knowledge of the dissolution, a member or manager may bind the LLC with respect to matters outside those appropriate to winding up.[61] At the same time, the filing articles of dissolution, the entry of decree of dissolution or the filing of a certificate of dissolution shall be presumed to constitute notice of the LLC's dissolution.[62]

(3) Pages 176-82. Replace the entirety of § 9.5 to read as follows:

[9.5] The Effect of Reinstatement After Administrative Dissolution

An LLC, having been administratively dissolved and assuming it has not acted to notify its creditors and otherwise wind up and liquidate its business and affairs,[63] may apply for reinstatement. Assuming reinstatement is granted:

> [I]t shall relate back to and take effect as of the effective date of the administrative dissolution and the entity shall resume carrying

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60 KY. REV. STAT. ANN. §§ 275.305(1)(a); (3)

61 KY. REV. STAT. ANN. § 275.305(1)(b).

62 KY. REV. STAT. ANN. § 275.305(2).

63 KY. REV. STAT. ANN. § 14A.7-030(4).

> on its business as if the administrative dissolution or revocation had never occurred.[64]

A frequently litigated point is the contractual or tort liability of those who acted on behalf of the administratively dissolved LLC during the period between the dissolution and the subsequent reinstatement.[65] Essentially, the plaintiff argues that during the period of dissolution the LLC lacked the capacity to undertake acts not appropriate to its winding up and liquidation,[66] and thus the persons purporting to act on the LLC's behalf were actually acting as principals and are therefore personally liable on the contract. The defendant argues that because reinstatement relates back to the initial administrative dissolution,[67] the dissolution is of no legal effect and the rules governing the personal liability of the agents should be applied as if the dissolution never occurred.

The position of the defendant is correct, a conclusion confirmed by a 2012 amendment to the statute.

Initially, it is important in analyzing this question to be exceptionally careful in relying upon court decisions. Many are dated and of no utility. For example, in *Steele v. Stanley*,[68] the Court held that the shareholders of a corporation are liable for all debts and obligations undertaken after dissolution. At the time of that ruling, a corporation's dissolution terminated its

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[64] KY. REV. STAT. ANN. § 14A.7-030(3). Prior to January 1, 2011, this rule was set forth at KRS § 275.295(3)(c).

[65] *See, e.g.*, *Forleo v. American Products of Kentucky, Inc.*, 2006 WL 2788429 (Ky. Ct. App. 2006); *Fairbanks Arctic Blind Co. v. Prather & Associates, Inc.*, 198 S.W.3d 143 (Ky. App. 2005); *Esselman v. Irvine*, No. 1997-CA-001155-MR (Ky. App. Jan. 8, 1999); and *Pannell v. Shannon*, 2011 WL 3793415 (Ky. App. 2011). *Messing v. Paul*, 147 Fed. Appx. 437 (6th Cir. 2005) involved liability absent reinstatement. Another decision not involving reinstatement is *Pelsor v. Petoria, Inc.*, 2011 WL 1434641 (W.D. Ky. 2011). The *Pelsor* case is interesting. The corporation at issue was administratively dissolved and was not reinstated, so the effect of the reinstatement statute is actually not at issue. The interesting point is that the plaintiff is a shareholder in the defendant corporation; he is, in effect, asserting that his co-shareholders are infringing on his IP. The plaintiff has used his voting position in the corporation to preclude it from reinstating.

[66] *See* KY. REV. STAT. ANN. § 14A.7-020(3) ("An entity administratively dissolved continues its existence but shall not carry on any business except that necessary to wind up and liquidate its business and affairs."); *id*. § 275.300(2) ("A dissolved [LLC] shall continue its existence but shall not carry on any business except that appropriate to wind up its business and affairs."); *accord id*. § 271B.14-050(1) ("A dissolved corporation shall continue its corporate existence but may not carry on any business except that appropriate to wind up and liquidate its business and affairs."); *see also Stearns Coal & Lumber Co. v. Douglas*, 185 S.W.2d 385 (Ky. 1944) (a dissolved corporation continues to exist for the purpose of settling its affairs and paying its creditors).

[67] KY. REV. STAT. ANN. § 14A.7-030(3) ("as if the administrative dissolution or revocation had never occurred.").

[68] 35 S.W.2d 867 (Ky. 1931).

legal existence.[69] Further, in this era there was neither administrative dissolution nor, crucially for these purposes, reinstatement after dissolution.[70] Under the modern system, a dissolved entity continues to exist and retains the power and authority to wind up and liquidate its affairs.[71] After the filing of the articles of dissolution (or administrative dissolution) the entity is restricted to activities appropriate for its winding up and liquidation even as it continues to exist.[72] Ergo, the *Steele* decision (and others of its milieu) fails to account for the statutory developments that give rise to this question. Even in more modern decisions from other jurisdictions,[73] the outcome often hinges on the specific statutory language, and these differences between the states' formulae may preclude reliance on the analysis employed and the conclusions reached.

[9.5.1] Irrespective of Reinstatement, an LLC Affords Its Members Limited Liability Even After Dissolution

In the case of an LLC, it must be initially recognized that the limited liability provision of the LLC Act is broader than is the limited liability provision of the Business Corporation Act. In the latter statute, it is provided that shareholders enjoy limited liability from the debts and obligations of the corporation.[74] The statute is silent as to the limited liability that is enjoyed by both the directors and the officers.[75] In contrast, the LLC Act, in addition to providing that the

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[69] *See*, *e.g.*, 16A WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 8113. Of course a plaintiff relying upon this reasoning could well find themselves hoist upon their own petard. Under the law of that era, a corporation's dissolution extinguished its debts. *See also* II STEWART KYD, A TREATISE ON THE LAW OF CORPORATIONS 516 (1794) ("The effect of the dissolution of a corporation is, that all its lands revert to the donor; its privileges and franchises are extinguished; and the members can neither recover debts which were due to the corporation, nor be charged with debts contracted by it, in their natural capacities."); JAMES GRANT, A PRACTICAL TREATISE ON THE LAW OF CORPORATIONS IN GENERAL AS WELL AGGREGATE AS SOLE 314 (T. & J.W. Johnson 1854) (upon dissolution "The corporation is wholly gone, and with it are also lost and avoided all its claims, debts, and liabilities of all kinds.")

[70] The "relates back" language came into Kentucky law with the 1988 adoption of KRS § 271B.14-220. The prior statute (KRS § 271A.615) was silent as to whether reinstatement related back or was only prospective.

[71] *See* KY. REV. STAT. ANN. § 14A.7-020(3); *see also Greene v. Stevenson*, 175 S.W.2d 519, 523-24 (Ky. 1943) (the purpose of statutes for the extension of corporate existence after dissolution "is to abrogate the common law rules relative to the reversion of corporate real estate, escheat of its personal property, and extinguishment of the debts owed by and to it").

[72] *See* KY. REV. STAT. ANN. § 14A.7-020(3). It may be said that upon dissolution, whether voluntary, judicial or administrative, that the purpose of the LLC is to wind up and liquidate its business and affairs.

[73] See generally Annotation, *Reinstatement of Repealed, Forfeited, Expired, or Suspended Corporate Charter as Validating Interim Acts of Corporation*, 42 A.L.R. 4th 392.

[74] KY. REV. STAT. ANN. § 271B.6-220(2).

[75] The limited liability enjoyed by the officers of a corporation is an issue not of the law of corporations, but rather the law of agency. *See*, *e.g.*, RESTATEMENT (THIRD) OF AGENCY § 6.01 (2006);

members enjoy limited liability from the LLC's debts and obligations, goes on to extend that protection to the managers, employees and agents of the LLC.[76] As such, the grant of limited liability by the LLC Act extends significantly further than does that afforded by the corporate law.

An LLC continues to exist as an LLC after dissolution.[77] The dissolution of an LLC does not cause any of the members, managers, employees or agents of the LLC to cease being in those roles. If, after dissolution, an LLC remains an LLC (and the statute says that is the case) and an LLC affords each of its members, managers, employees and agents limited liability from its debts and obligations (and the statute says that is the case) it necessarily follows that even after dissolution the LLC continues to afford the members, managers, agents and employees of the LLC limited liability from its debts and obligations.

[9.5.2] Upon Reinstatement After Administrative Dissolution, There is Limited Liability for Actions Undertaken After Dissolution and Before Reinstatement

A dissolved LLC continues to exist as an LLC.[78] From the administrative dissolution, the LLC is restricted to activities appropriate for its winding up and liquidation.[79] Upon reinstatement, it is as if the administrative dissolution had never taken place;[80] the existence of the LLC continues without interruption. In that an effect of reinstatement is that if the LLC's existence has not been interrupted, then the limited liability enjoyed by its agents is likewise uninterrupted.[81]

This rule is consistent with the Restatement (Third) of Agency (the "Restatement"). Putting the issue in agency terms, Agent A, on behalf of Principal P, has both actual and apparent agency authority conferred at a time when P was fully competent. At some later time, P becomes incapacitated. During P's incapacity, in the ordinary course of what would otherwise

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RESTATEMENT (SECOND) OF THE LAW OF AGENCY § 320 (1958). While it is unquestioned that directors enjoy limited liability, the analytic underpinnings for that determination are open to debate.

[76] KY. REV. STAT. ANN § 275.150(1).

[77] KY. REV. STAT. ANN § 275.300(2) ("A dissolved [LLC] shall continue its existence…."); *id.* § 14A.7-020(3) ("An entity administratively dissolved continues its existence…."). Simply put, the "dissolution" of an LLC does not terminate its existence.

[78] *See* KY. REV. STAT. ANN. § 14A.7-020(3).

[79] *See id.*

[80] KY. REV. STAT. ANN. § 14A.7-030(3) ("as if the administrative dissolution or revocation had never occurred.").

[81] *See also* KY. REV. STAT. ANN. § 275.003(1) ("Unless displaced by particular provisions of this chapter, the principals of law and equity shall supplement this chapter.").

be P's line of business and having fully disclosed P's identity as the principal, A enters into a contract with third-party ("TP"). At some point thereafter, P regains competency and expressly ratifies A having, during the period of incapacity, entered into the agreement with TP on P's behalf. Thereafter, P defaults on the agreement with TP.

Initially, even if A was not aware of P's incapacity, by entering into the contract with TP while P was incapacitated, A violated his warranty of authority[82] and is potentially liable to TP on the obligation.[83] Still, by ratification[84] after the incapacity was lifted, P agreed to be bound on the contract with TP. The question is whether P's ratification of A's conduct during the period of incapacity cures A's breach of the warranty of authority such that TP does not have recourse against A upon P's default. The answer is that TP has no recourse against A.

The clearest authority for the proposition that the agent would not, on these facts, be personally liable for P's obligations on the agreement is the Restatement (Third) of Agency section 4.02, which addresses the "Effect of Ratification." Presuming that the LLC ratifies the actions undertaken during the period of incapacity (administrative dissolution), section 4.02(1) provides:

> Subject to the exceptions stated in subsection (2), ratification retroactively creates the effects of actual authority.

It is important to consider as well section 4.01(1) of the Restatement, defining "ratification," it providing:

> Ratification is the affirmance of a prior act done by another, whereby the act is given effect as if done by an agent acting with actual authority.[85]

Official comment (b) to section 4.02 of the Restatement provides in part:

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[82] *See* RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006); *see also* 3 AM.JUR.2d *Agency* § 295 (2008) ("Generally, one who contracts as an agent in the name of a non-existent or fictitious principal, or a principal without legal status or existence, is personally liable on a contract so made.").

[83] *See* RESTATEMENT (THIRD) OF AGENCY § 6.04 (2006) ("Unless the third party agrees otherwise, a person who makes a contract with a third party purportedly as an agent on behalf of a principal becomes a party to the contract if the purported agent knows or has reason to know that the purported principal does not exist or lacks capacity to be a party to a contract.").

[84] *See id.* § 4.02.

[85] *See also* RESTATEMENT (THIRD) OF AGENCY § 4.03 (2006) ("A person may ratify an act if the actor acted or purported to act as an agent on the person's behalf.").

> Ratification has an immediate effect on legal relations between the principal and agent, the principal and the third party, and the agent and the third party. Ratification recasts those legal relations as they would have been had the agent acted with actual authority. Legal consequences thus "relate back" to the time the agent acted.

Ergo, even if during the period of administrative dissolution the entity could not authorize an agent to undertake an act not relating to its winding up and liquidation,[86] upon reinstatement the entity's ratification of such actions causes the agent to have been vested with actual authority.[87] Having actual authority to act on the principal's behalf (and assuming identification of the principal), the agent is not personally obligated on the agreement.[88]

This analysis is consistent with recent Kentucky decisions with the exception of the unsound *Forleo* decision. In that unpublished decision, in partial reliance upon *Steele v. Stanley*,[89] the Court held that the corporation's reinstatement after administrative dissolution[90] did not impact upon the personal liability of the shareholders and officers for debts incurred after dissolution and prior to reinstatement. Further, the Court relied upon the "resume" language in KRS § 271B.14-040(5) for the proposition "The 'shall resume' language necessarily implies that the corporation ceased doing business as required by KRS 271B.14-210(3)."[91]

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[86] *See, e.g.*, KY. REV. STAT. ANN. § 14A.7-020(4); RESTATEMENT (THIRD) OF AGENCY § 3.04(2) (2006).

[87] *See* RESTATEMENT (THIRD) OF AGENCY, Ch. 4, Introductory Note (2006); *id.* § 4.01, comment b ("That is, when a person ratifies another's act, the legal consequence is that the person's legal relations are affected as they would have been had the actor been an agent acting with actual authority at the time of the act.").

[88] *See* RESTATEMENT (THIRD) OF AGENCY § 6.01 (2006). This rule as to the effect of ratification and the consequent release of the agent from personal liability on the contract is in no manner a recent innovation in the law. *See, e.g.*, ERNEST W. HUFFCUT, THE LAW OF AGENCY INCLUDING THE LAW OF PRINCIPAL AND AGENT AND THE LAW OF MASTER AND SERVANT at § 49 (p. 61) (Little, Brown & Co., 1901) ("An agent after ratification of his unauthorized act by his principal is in the same relation to the third party as if the acts had been previously authorized. The principal alone is generally liable on the contract he has ratified, ….").

[89] *Forleo*, 2006 WL 2788427, *1.

[90] Prior to January 1, 2011 and the Kentucky Business Entity Filing Act, the language employed in the LLC Act as to the effect of reinstatement and that employed in the Business Corporation Act were essentially identical. *Compare* KY. REV. STAT. ANN. § 271B.14-220(3) (prior to repeal by 2010 Ky. Acts, ch. 151, § 151) ("When the reinstatement is effective, it shall relate back to and take effect as of the effective date of the administrative dissolution or revocation and the corporation shall resume carrying on its business as if the administrative dissolution or revocation had never occurred.") *and* KY. REV. STAT. ANN. § 271B.14-040(5) ("When revocation of dissolution is effective, it shall relate back to and take effect as of the effective date of the dissolution and the corporation shall resume carrying on its business as if the dissolution never occurred.") *with* KY. REV. STAT. ANN. § 275.295(3)(c) (prior to repeal by 2010 Ky. Acts, ch. 151, § 151) ("When the reinstatement is effective, the reinstatement shall relate back to and take effect as of the effective date of the administrative dissolution, and the [LLC] shall resume carrying on business as if the administrative dissolution had never occurred.").

[91] *Forleo*, 2006 WL 2788429, *2.

As will be reviewed below, the *Forleo* decision conflicts with prior law and is an aberrational decision.

Esselman v. Irvine[92] should have been the definitive ruling on the matter, but unfortunately it was unpublished. Squarely addressing the effect of reinstatement upon the personal liability of an agent for an agreement entered into during the period of administrative dissolution and prior to reinstatement, the Court of Appeals affirmed the trial court's conclusion that reinstatement "'absolved [Irvine] of the personal liability that might have attached had his corporation remained dissolved.'"[93] Further, *Esselman* considered and rejected the notion that "resume" limited the effect of "shall relate back."[94]

The next consideration of the issue by the Court of Appeals was *Fairbanks Arctic Blind Co. v. Prather & Associates, Inc.*,[95] wherein it addressed an effort to dismiss a suit seeking enforcement of an agreement entered into while the corporation was administratively dissolved.[96] The Court of Appeals[97] held that:

> When the General Assembly stated in KRS 271B.14-220(3) that reinstatement shall relate back to and take effect as of the effective date of the administrative dissolution … and the corporation shall resume carrying on its business as if the administrative dissolution … had never occurred[.]
>
> We conclude, applying the rationale of *J.B. Wolfe* and *Joseph A. Holpuch* that it [the General Assembly] intended for reinstatement to restore a corporation to the same position it would have occupied had it not been dissolved and that reinstatement validates any action taken by a corporation between the time it was

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92 No. 1997-CA-001155-MR (Ky. App. 1999).

93 *Id*., Slip op. at 5; *see also id*. at 8 ("By allowing a corporation to be reinstated at "any time" after an administrative dissolution has taken place and by specifically stating that such a reinstatement shall relate back to the date of the administrative dissolution and shall operate as if the administrative dissolution has never occurred the clear intent of the statute is unambiguous. As such the finding of the trial court in this matter – that the reinstatement of ICM absolves Irvine of personal liability – is not clearly erroneous.") (emphasis in original).

94 *Id*. at 8.

95 198 S.W.3d 143 (Ky. App. 2005).

96 *Id*. at 144 ("On January 30, 2004, Prather, pursuant to Kentucky Rules of Civil Procedure (CR) 12, moved to dismiss Fairbanks' claim on the ground that, according to Kentucky Revised Statutes (KRS) 271B.14-210, a corporation that has been administratively dissolved is prohibited from carrying on any business except that which is necessary to wind up and liquidate its business. Since Fairbanks had been administratively dissolved in 1991, Prather argued, it was prohibited from entering into the 1993 contract and thus the contract was null and void.").

97 Apparently unaware of its prior decision in *Esselman*, the *Fairbanks* Court thought "Since this is an issue of first impression in the Commonwealth, …." *Id*. at 145.

> administratively dissolved and the date of its reinstatement. Simply put, the General Assembly meant what is said, that upon reinstatement, it is "as if the administrative dissolution … had never occurred."[98]

At this juncture the *Esselman* and *Fairbanks* opinions consistently state the view that upon reinstatement the agent is not liable upon agreements entered into on behalf of the entity after administrative dissolution and before reinstatement. It should be recognized that this rule is consistent with that described as being accepted by most jurisdictions:

> In most jurisdictions, the reinstatement of a corporation following dissolution by administrative action of the court relates back to the effective date of dissolution, and directors or officers are not personally liable for actions taken during the period of dissolution or suspension. Such matters become the exclusive liability of the corporation.[99]

The *Forleo* decision was rendered in September, 2006, eleven months after the October, 2005 decision rendered in *Fairbanks*; how was it decided notwithstanding the *Fairbanks* decision? Likely we will never have a clear answer to the question. What is clear is that *Fairbanks* was not cited in the briefs submitted to the Court of Appeals panel considering the *Forleo* appeal,[100] and it must be assumed that the Court's own research did not reveal the prior published law on the topic.

In *Eve v. Cosmo's LLC*,[101] the Court considered an argument based upon the "resume" language of the statute; of course, this was the same argument that had been considered and rejected in *Esselman v. Irvine*[102] to the effect that there should not be limited liability for actions undertaken during the period of administrative dissolution and prior to restatement. Rejecting that argument, the Court held:

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[98] *Id*. at 146 (citation omitted). The Court of Appeals rejected an effort to apply the statutory "resume" to limit the effect of the statute. "Prather urges us to focus solely on the word 'resume' found in KRS 271B.14-220(3) and construe the statute to disavow interim corporate activities. This would effectively redact the statute to read, 'When the reinstatement is effective … the corporation shall resume carrying on its business[.]' However, as noted above, we may not subtract language from a statute nor may we render any of its language meaningless, if we can avoid doing so. Since Prater's interpretation would do so, we decline to adopt it." This determination was obviously consistent with that in *Esselman*.

[99] 16A FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 8117.

[100] *See* Brief for Appellants Dean Forleo and John Tandy dated September 6, 2005 and Brief for Appellees dated November 2, 2006.

[101] Case No. 06-188-DLB, Memorandum Order (E.D. Ky. Mar. 27, 2008).

[102] *See supra* notes 92 through 94 and accompanying text.

> By including the language that reinstatement relates back to the date of the administrative dissolution, the Court believes that the legislature meant what it said, to wit, that a § 275.295 reinstatement cures the dissolution, and that cure is effective as of the date of dissolution…. The situation herein is similar [to that in *Fairbanks*], where the alleged tortious conduct occurred while the LLC was administratively dissolved but then reinstated later. If contracts that were entered into on behalf of the dissolved corporation in *Fairbanks* were deemed valid by the Kentucky Court of Appeals, the Court believes Kentucky courts would similarly conclude when asked to interpret the LLC statute. As a result, Cosmo's LLC and its members will be able to take advantage of the limited liability that K.R.S. § 275.150(1) provides.

More recently, in *Pannell v. Shannon*,[103] the Court of Appeals rejected an effort to hold an individual liable on a lease entered into at the time the tenant LLC was administratively dissolved.[104] Relying upon *Fairbanks*, the Court wrote:

> [R]einstatement restores a corporation to the same position it would have occupied had it not been dissolved and that reinstatement validates any action taken by a corporation between the time it was administratively dissolved and the date of its reinstatement. Simply put, the General Assembly meant what it said, that upon reinstatement, it is "as if the administrative dissolution … had never occurred." *Fairbanks Arctic Blind Co.*, 198 S.W.3d at 146. As reinstatement of a limited liability company relates back to the effective date of dissolution and operates as if dissolution never occurred, it naturally follows that members of such company are not individually liable for actions undertaken on behalf of the company during dissolution. *See Fairbanks Arctic Blind Co.*, 198 S.W.3d 143. Hence, the subsequent reinstatement of Elegant Interiors as a limited liability company "related back" to date of its dissolution, and Shannon cannot be held individually liable for any actions undertaken on behalf of Elegant Interiors while it was administratively dissolved.[105]

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[103] 2011 WL 3793415 (Ky. Ct. App. 2011). The Kentucky Supreme Court granted discretionary review in this case, and oral arguments were held on February 14, 2013.

[104] *Id*. at *3 ("Alternatively, Pannell argues that Shannon is individually liable because Elegant Interiors was administratively dissolved as a limited liability company at the time of execution of the March 2006 lease.").

[105] *Id*. at 4.

Further, the Court chastised the plaintiff for citing the *Forleo* decision in its brief, noting that CR 76.28(4)(c) permits the citation of unpublished authority only when there is a "complete lack of published authority upon an issue."[106] Clearly, at least this panel of the Court of Appeals accepted that *Fairbanks* is the final authority on this point.[107]

The most recent published judicial examination of the point (at least as of this writing) is that by Judge Coffman in *eServices, LLC v. Energy Purchasing, Inc*.[108] When Energy Purchasing defaulted on a contract with eServices, the contract having been entered into while Energy Purchasing was administratively dissolved, it sought to hold Buchart, its agent, personally liable thereon. Energy Purchasing defended on the ground that it had been reinstated, thereby relieving Buchart of any personal liability. Judge Coffman agreed:

> Because Energy Purchasing was reinstated after Buchart signed the contracts, the corporation is treated as having been in existence when the contracts were signed…[109]

eServices had pinned its hopes on the *Forleo* decision. Judge Coffman dissected and discarded any application of *Forleo*, finding its reasoning unpersuasive, that it conflicted with the operation of the express statutory language and as well conflicted with the published *Fairbanks* decision.[110]

Most recently, in *Harshman Construction & Electric, Inc. v. Witte*,[111] the plaintiffs sought to hold certain of the defendant's representatives personally liable on their claim on the basis that the defendant corporation was administratively dissolved while performing on the subject contract; it was subsequently reinstated.

Reversing the determination that the individuals were personally liable, the Court parsed KRS § 271B.14-220(3), the predecessor to now applicable KRS § 14A.7-030, both of which provide that upon the reinstatement of a dissolved entity, the reinstatement shall "relate back to and take effect as of the effective date of the administrative dissolution or revocation" and the

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106 *Id*., note 22.

107 The decision of the Court of Appeals was appealed to the Kentucky Supreme Court, and oral arguments were heard on February 14, 2012.

108 2012 WL 404957 (E.D. Ky. Feb. 6, 2012).

109 2012 WL 404957,*2.

110 2012 WL 404957, *2-3; *Fairbanks Arctic Blind Co. v. Prather & Assoc*., 198 S.W.3d 143 (Ky. App. 2005).

111 No. 2011-CA-000609-MR, 2012 WL 2471445 (Ky. App. June 29, 2012) (Not To Be Published).

organization shall proceed forward as if the administrative dissolution "had never occurred."[112] Noting that the statute does not impose a time limitation for seeking reinstatement after administrative dissolution, it relied upon the 2005 ruling of the Court of Appeals in *Fairbanks*, the *Harshman* Court writing that:

> As reinstatement of a corporation relates back to the effective date of dissolution and operates as if dissolution never occurred, it naturally follows that the shareholders and officers of such corporation are not individually liable for actions undertaken on behalf of the corporation during its dissolution.[113]

In an effort to reduce to statute the rules consistently set forth in *Esselman*, *Fairbanks*, *Pannell* and *eServices* (as well anticipating the holding in *Harshman*) and to reject the aberrational *Forleo* decision, the 2012 General Assembly enacted two statutory amendments to KRS § 14A.7-030. First, but of smaller importance, "resume" was deleted and "continue" was substituted in place thereof.[114] Second and of greater import, a new subsection (3)(c) was added to the statute, it defining one effect of reinstatement as:

> The liability of any agent shall be determined as if the administrative dissolution or revocation had never occurred.[115]

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112 Slip Op. at 5.

113 Slip Op. at 6.

114 *See* KY. REV. STAT. ANN. § 14A.7-030(3)(b) as amended by 2012 Ky. Acts, ch. 81, § 83.

115 *See* KY. REV. STAT. ANN. § 14A.7-030(3)(c) as created by 2012 Ky. Acts, ch. 81, § 83. *See also* Rutledge, *The 2012 Amendments to Kentucky's Business Entity Statues*, 101 KY. L.J. ONLINE 1, 11 (2012-13).