Spring | 17

2017 Amendments to the Illinois Limited Liability Company Act: What You Need to Know

Illinois State Bar Association

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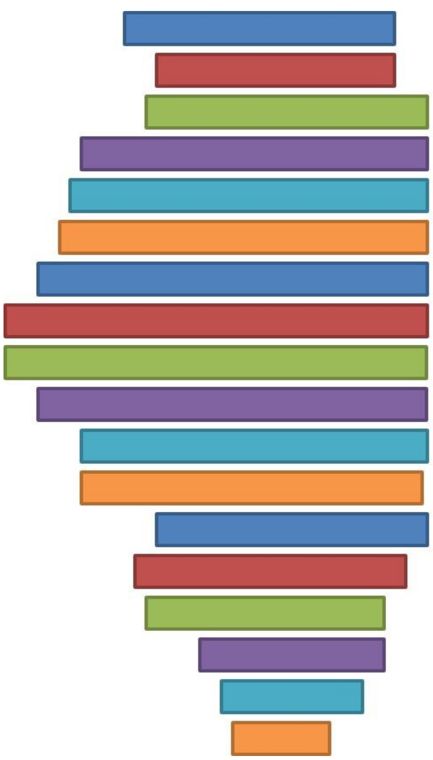
YOUR ILLINOIS BAR FOUNDATION

The IBF has **FOUR** programmatic components to further its mission:

Access to Justice Grants
Warren Lupel Lawyers Care Fund
Post-Graduate Legal Fellowships
Illinois JusticeCorps

OUR SUCCESS IS YOUR SUCCESS

In fiscal year 2014- 2015, the IBF invested more than **$767,000** to enhance **access to justice** and to assist lawyers and their families in **need.**



ILLINOIS BAR FOUNDATION'S MISSION

Illinois Bar Foundation's mission is to ensure meaningful access to the justice system, for those with limited means, and to assist lawyers who can no longer support themselves.

ACCESS TO JUSTICE GRANTS

This year, the IBF awarded 23 grants ranging from $5,000 to $15,000 to organizations across the state to provide legal aid, promote pro bono services, or provide legal information for those who can't afford an attorney.

WARREN LUPEL LAWYERS CARE FUND

The IBF supported many attorneys and their families across Illinois to help them get back on their feet and maintain a modest standard of living. More than $90,000 went to support these attorneys and families.

POST-GRADUATE LEGAL FELLOWSHIPS

The IBF is excited to announce the 2015-2016 Fellowship participants! Calli Burnett is working at Loyola University Chicago's Community Law Center, Bryan McIntyre is working at the University of Illinois' Civil Litigation Legal Clinic, and Marishonta Wilkerson is working at Northern Illinois University's Zeke Giorgi Law Clinic. Fellowships add more attorneys to the legal aid field and help recent law graduates hone the skills they need to practice law.

JUSTICECORPS

This innovative AmeriCorps program enlists student volunteers to serve as guides to make courts across Illinois more welcoming and less intimidating for people without lawyers. Illinois JusticeCorps recruits, trains, and provides the necessary support for college and law students to offer procedural and navigational assistance in courthouses statewide. This fiscal year, the program expanded from 3 to 9 courthouses in Illinois.

SUPPORTED BY

The IBF is supported by attorneys, law firms, and other businesses serving legal communities in Illinois. Thank you for your continued support of these very worthy causes.

YOUR ILLINOIS BAR FOUNDATION

WHERE THE FUNDS GO

45% First District Support

32% Second-Fifth District Support

23% Statewide Support

2015-2016 Grant Recipients

ADMINISTER JUSTICE

CABRINI GREEN LEGAL AID

CARPLS LEGAL AID

CENTER FOR DISABILITY AND ELDER LAW

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PUBLIC INTEREST LAW INITIATIVE

THE IMMIGRATION PROJECT

THE PARENT PLACE

THE CHICAGO LIGHTHOUSE

UPTOWN PEOPLES' LAW CENTER

THE FELLOWS OF THE IBF

Join or upgrade your Fellows pledge today and receive a special thank you gift from the Illinois Bar Foundation.

WHO WE ARE

CREATED IN 1983, THE FELLOWS PROGRAM CONSISTS OF A SPECIAL GROUP OF LAWYERS WHO HAVE COMMITTED, BY DIRECT PAYMENT OR PLEDGE OVER TEN YEARS, SUMS OF MONEY RANGING FROM $1,000 TO $25,000 TO HELP FUND THE FOUNDATION'S GRANTS PROGRAMS AND ASSIST LAWYERS IN NEED.

HOW IT WORKS

FELLOWS CAN MAKE MONTHLY, QUARTERLY, OR ANNUAL PAYMENTS TOWARD THEIR SELECTED PLEDGE VIA CHECK, CREDIT CARD, OR RECURRING AUTOMATIC PAYMENTS. ALL FELLOWS PAYMENTS ARE TAX DEDUCTIBLE TO THE EXTENT ALLOWED BY LAW.

WHAT WE DO

THROUGH THE GENEROUS SUPPORT OF OUR FELLOWS AND OTHER DONORS, THE ILLINOIS BAR FOUNDATION IS ABLE TO:

--Award Access to Justice Grants to organizations across the state to provide legal aid, promote pro bono services, or provide legal information for those who can't afford an attorney

--Support lawyers and their families who have fallen on hard times through the Warren Lupel Lawyers Care Fund

--Fund Post-Graduate Legal Fellowships at three Illinois law schools' legal aid clinics, giving recent law graduates the opportunity to hone skills they will use throughout their careers while adding more attorneys to the legal aid field

--Facilitate the Illinois JusticeCorps program, an innovative AmeriCorps program which enlists student volunteers to serve as guides to make courts across the state more welcoming and less intimidating for people without lawyers

THE FELLOWS
ILLINOIS BAR FOUNDATION

Membership Application

Deane B. Brown, Chair, The Fellows
Susan Brazas, Vice Chair, The Fellows
Lisa M. Nyuli, Secretary, The Fellows

The mission of the Illinois Bar Foundation is to ensure meaningful access to the justice system, and to assist lawyers and their families that have fallen upon hard times. This year, the Foundation will distribute more than $400,000 to programs that enhance our system of justice and as payments to lawyers or their survivors who have fallen on hard times due to age, illness or other tragedy.

Name ____

Address ____

City ___________________Zip _________ Phone _________________Email __________________

Date of Birth ________________________ Date of Admission to Illinois Bar _____________________

Law School ____

I want to join The Fellows at the following level:

☐ **Fellow**	**$1,000**	or	**$100 per year**
☐ **Silver Fellow**	**$2,000**	or	**$200 per year**
☐ **Gold Fellow**	**$5,000**	or	**$500 per year**
☐ **Diamond Fellow**	**$10,000**	or	**$1000 per year**
☐ **Pillar of Profession**	**$15,000**	or	**$1,500 per year**
☐ **Pillar of Foundation**	**$25,000**	or	**$2,500 per year**

I want to increase my Fellows membership to:
(All previous Fellows pledge payments will be credited to the new level)

☐ **Silver Fellow**	**$2,000**
☐ **Gold Fellow**	**$5,000**
☐ **Diamond Fellow**	**$10,000**
☐ **Pillar of Profession**	**$15,000**
☐ **Pillar of Foundation**	**$25,000**

**Pledges may be payable over ten years.

PAYMENT INFORMATION

☐ My check, made payable to the Illinois Bar Foundation, for $_______ is enclosed.

☐ Please charge my Visa/MasterCard/American Express $___________.

Account No: ____ Exp. Date: _____________

Signature ____

Amount $________ Signature __________________________________ Date ______________

☐ Please charge my card:

***Your first installment will be charged immediately**

$______ monthly (on the 1st of every month)

$______ quarterly (July 1st, October 1st, January 1st, April 1st)

$______ yearly (July 1st)

Complete this application and return it to: Illinois Bar Foundation
20 South Clark, Suite 910, Chicago, IL 60603. Have a question? Call (312) 726-6072

Table of Contents

2017 Amendments to the Illinois Limited Liability Company Act:
What You Need to Know
Presented by the ISBA Business & Securities Law Section

Chicago
Thursday, April 13, 2017
ISBA Regional Office
20 S. Clark Street, Suite 900
12:55 – 5:00 p.m.

– or –

Live Webcast
Thursday, April 13, 2017
12:55 – 5:00 p.m.

3.75 hours MCLE credit

Don't miss this half-day seminar that explores a number of things you need to know about the 2017 Amendments to the Illinois Limited Liability Company Act, including how the Act existed prior to the amendments (compared to how it exists after), the critical changes to the provisions of the Act, what affect the amendments will have on operating agreements, and how the amendments change certain mandatory rules. Additional topics include:

- An explanation of the process of Institute and its LLC Committee;
- The rights and obligations of transferees, dissociated members, and creditors;
- Changes to third party rights;
- Changes to fiduciary obligations;
- Indemnification and insurance issues;
- The formation, reporting, dissolution, and termination reporting requirements;
- How the amendments provide for new drafting considerations and possibilities;
- Electronic records and signatures;
- Annual reports; and
- Much more.

Program Coordinator:
Cory White, *The International Business Law Group, Chicago*

Program Moderator:
Philip N. Hablutzel, *Chicago-Kent College of Law (Professor-Emeritus), Chicago*

Program Speakers:
John L. Eisel, *Locke Lord LLP, Chicago*
Steven G. Frost, *Institute of Illinois Business Law, Chicago*
Robin Heiss, *Institute of Illinois Business Law, Chicago*
Charles W. Murdock, *Loyola University Law School, Chicago*

TAB 1

2017 AMENDMENTS TO THE ILLINOIS LIMITED LIABILITY COMPANY ACT:

WHAT YOU NEED TO KNOW

Presented by the ISBA Corporation, Securities and Business Law Section Council

Thursday, April 13, 2017

TOPICS:

- **INFORMATIONAL RIGHTS**
- **CONVERSIONS, DOMESTICATIONS AND MERGERS**

PREPARED BY JOHN EISEL

INFORMATIONAL RIGHTS

I. Section 1-40. Records to be kept.

A. Each LLC shall keep the following Records:

(1) A list of the full name and last known address of each member setting forth the amount of cash each member has contributed, a description and statement of the agreed value of the other property or services each member has contributed or has agreed to contribute in the future, and the date on which each became a member.

(2) A copy of the articles of organization, as amended or restated, together with executed copies of any powers of attorney under which any articles, application, or certificate has been executed.

(3) Copies of the limited liability company's federal, State, and local income tax returns and reports, if any, for the 3 most recent years.

(4) Copies of any then effective written operating agreement and any amendments thereto and of any financial statements of the limited liability company for the 3 most recent years.

B. Any member, legal representative or member under legal disability may inspect and copy these records – no purpose need be stated.

C. New Section 1-40 (c) extends the rights to inspect and copy the 1-40 records to a transferee of a distributional interest but only for a proper purpose.

(1) Transferee must make written demand stating with particularity the records sought and the purpose of the demand.

(2) Within 10 days of the demand.

(a) The company shall provide the information or alternatively describe the information the company will provide stating a reasonable time within which it will provide the information, and

(b) If the company declines to provide any demanded information, the company shall state its reasons for declining

D. The operating agreement may not unreasonably restrict a right to information or access to records under Section 1-40. This provision is new; under old statute this limitation applied only to rights to information under Section 10-15.

E. The Delaware LLC Act provides that the company maintain generally similar records but only for "any purpose reasonably related to the member's interest as a member of the limited liability company." (Section 18-305)

F. Shareholders of Illinois corporations have a right to examine the corporation's books and records of account, minutes, voting trust agreements and record of shareholders "only for a proper purpose." 805 ILCS §5/7.75

II. <u>Section 10-15. Right of members and dissociated members to information.</u>

A. A company shall furnish information when any member demands it in a record concerning the company's activities, financial condition, and other circumstances of the company's business necessary to the proper exercise of a member's rights and duties under the operating agreement or this Act or that is otherwise material to the membership interest of a member, unless the company knows that the member already knows that information.

B. New Section 10-15 (c) (which was taken verbatim from RULLCA §410(b)(4)) provides that a company has an affirmative obligation to provide information where a member is asked to give or withhold consent to a matter as follows:

> Whenever this Act or an operating agreement provides for a member to give or withhold consent to a matter, before the consent is given or withheld, the company shall, without demand, provide the member with all information that is known to the company that is material to the member's decision.

C. Section 10-15 (d) provides that a dissociated member may have access to information to which the person was entitled while a member if the information pertains to the period during which the person was a member, and the person seeks the information in good faith for a purpose consistent with subsection (a).

D. The rights in Section 10-15 do <u>not</u> apply to transferees.

E. Section 10-15 (h) provides that a company may impose "reasonable restrictions and conditions on access to and use of information" and specifically identifies trade secrets and information subject to confidentiality agreements with third parties as covered by the section. The company bears the burden of proving reasonableness.

CONVERSIONS, DOMESTICATIONS AND MERGERS

ARTICLE 37

I. Conversions – Sections 37-10 through 37-17.

A. Existing Act – Sections 37-10 and 37-15.

1. Section 37-10 permits the conversion of a partnership or limited partnership to a limited liability company. Note: The existing Act authorizes only conversions where the LLC is the converted organization and is available only to partnerships and limited partnerships.

2. The Illinois Uniform Partnership Act authorizes (i) a conversion of an Illinois partnership into an Illinois limited partnership (805 ILCS 206/902), (ii) the conversion of an Illinois limited partnership to an Illinois partnership (805 ILCS 206/903) and (iii) the conversion of an Illinois partnership into an Illinois limited liability company (805 ILCS 206/909). Note: No cross-state conversions are authorized.

3. The Illinois Uniform Limited Partnership Act has much broader conversion provisions permitting conversions into and from all statutory organizations and between domestic and foreign organizations. The existing Illinois Uniform Limited Partnership Act conversion provisions are substantially the same as the new Illinois Limited Liability Company conversion provisions.

B. Amended Act

1. Definition of Organization – Section 37-5:

"Organization" means a general partnership, including a limited liability partnership, limited partnership, including a limited liability limited partnership, limited liability company, business trust, corporation, or any other person having a governing statute. The term includes a domestic or foreign organization regardless of whether organized for profit.

2. Authorization to Convert – Section 37-10.

Section 37-10. Conversion

(a) An organization other than a limited liability company or a foreign limited liability company may convert to a limited liability company, and a limited liability company may convert to an organization other than a foreign limited liability company pursuant to this Section, Sections 37-15 through 37-17, and a plan of conversion, if:

(1) the other organization's governing statute authorizes the conversion;

(2) the conversion is not prohibited by the law of the jurisdiction that enacted the other organization's governing statute; and

(3) the other organization complies with its governing statute in effecting the conversion.

3. Plan of Conversion.

a. Name and form of organization before and after.

b. Terms of the conversion including "manner and basis for converting interests in the converting organization into any combination of money, interests in the converted organization and other consideration."

c. Organizational documents of the converted organization.

4. Approval Requirements.

a. Default rule – plan of conversion must be consented to by all the members of a converting limited liability company. Section 37-16 (a)

b. The operating agreement may provide for approval by fewer than all of the members but if a member of a converting LLC will have personal liability with respect to the converted organization then the member must have consented to the provision of the operating agreement that established the voting provision Section 37-36. The operating agreement may not change the protections of Section 37-36 (See Section 15-5(b)(11)).

5. Effect of Conversion (Section 37-15).

a. An organization that has been converted is "for all purposes the same entity that existed before the conversion."

b. All assets and liabilities of the converting LLC become assets and liabilities of the converted organization.

c. Any pending action or proceeding continues against the converted organization "as if the conversion had not occurred."

d. All of the rights, privileges, immunities powers, and purposes of the converting organization remain vested in the converted organization.

6. The converting organization must file Articles of Conversion with the Secretary of State.

II. Domestications – Sections 37-31 through 37-34

A. Existing Act – No provision for domestications.

B. Amended Act.

1. A foreign LLC may become an Illinois LLC and an Illinois LLC may become a foreign LLC through the domestication process provided that the foreign LLC's governing statute authorizes the domestication (Section 37-31).

2. The process is much like a conversion.

a. The LLC must adopt a Plan of Domestication.

b. Approval requirements are the same as for a conversion.

c. The effects of domestication are the same as a conversion. Particularly, "the domesticated company is for all purposes the company that existed before the domestication." Section 37-34(a)(1).

III. Mergers

A. The merger provisions under the existing act and the amended act are substantively the same.

IV. Entity Omnibus Act – House Bill 2963

A. Purpose of Act is to bring consistent rules for conversions and domestications to most entity statutes.

B. The proposed act uses the defined term "entity" (rather than "organization") as follows:

"Entity" means:

1. a business corporation;
2. a medical corporation;
3. a nonprofit corporation;
4. a professional service corporation;
5. a general partnership, including a limited liability partnership;
6. a limited partnership, including a limited liability partnership; and
7. a limited liability company.

Note: The definition specifically names a few additional entity statutes (a medical corporation and a professional corporation) but does not include a business trust and "any other person having a governing statute."

C. Conversions.

1. Domestic entities can convert into other domestic entities.

2. Foreign entities can convert into other Illinois entities.

3. Illinois entities are <u>not</u> authorized to convert into foreign entities.

D. Protected Agreement.

1. A protected agreement is defined very broadly as follows:

a. a record evidencing indebtedness and any related agreement in effect on the effective date of this Act:

b. an agreement that is binding on an entity on the effective date of this Act;

c. the organic rules of an entity in effect on the effective date of this Act; or

d. an agreement that is binding on any of the governors or interest holders of an entity on the effective date of this Act.

2. If a protected agreement contains a provision that applies to a merger of a domestic entity, but does not refer to a conversion or domestication, the provision applies to a conversion or domestication of the entity as if the conversion or domestication were a merger until the provision is amended after the effective date of this Act.

E. The Entity Omnibus Act amends the conversion and domestication provisions of the Amended Act to incorporate the provisions of the Entity Omnibus Act.

2017 Amendment to the Illinois Limited Liability Company Act:
What You Need to Know

Presented by the ISBA Corporation, Securities and Business Law Section Council

Thursday, April 13, 2017

Topics

Other Rights and obligation of members and managers

Formation, reporting, dissolution and termination

Prepared by Steve Frost

Other rights and obligations of members and managers

a. Admission of a member - Section 10-1

   - At formation – one member – agreement between organizer and member or agreement between members if more than one member. Note that this “agreement” is not the operating agreement as defined in section 1-5.

   - After formation – ability to have last member designate a new member or members within 180 days of withdrawal of last member. This right dovetails with dissolution provisions in section 35-1, but is in addition to the right of a legal representative in section 35-3 to designate a member within 1 year.

   - Ability to have non-economic members.

b. Management, decisions, consent requirements – Section 15-1

   - Default rule that an LLC is member-managed unless operating agreement provides otherwise. [Tied to deletion of requirement to designate in articles and (ir)relevance to third parties.]

   - Elimination of requirement that all members consent to interim distribution – tied to continuing requirement in Section 25-1 that all interim distributions must be made in equal shares unless all members agree otherwise.

   - Same logic for deletion of unanimous consent to waive a dissolution and winding up, which otherwise requires unanimous consent under Section 35-3.

c. Indemnification and insurance: Section 15-7

   - Change in standard for reimbursement of expenses and indemnification from “acting in ordinary course” to “if complied with duties.”

   - Clarification that LLC may buy insurance on behalf of a member or manager even against liability to LLC that may not be waived, e.g., beach of certain duties, intentional harm on company or a member or intentional violation of criminal law.

d. Contributions and distributions: Sections 20-1, 20-5 and 25-35

   - Broadening reasons in section 20-5 that do not waive obligations to make contributions, e.g., now no excuse.

- Addition of remedies in section 20-5 available against members who fail to make contributions, e.g., eliminating the member's interest in the LLC and forced sales of interest.

- Section 25-35 now provides that personal liability does not attach to a person expressly relieved of the authority and responsibility to consent to the distribution and eliminates liability for an improper distribution if the distribution violates the operating agreement but not section 25-20 if the vote would have been sufficient to amend the operating agreement.

e. Personal representative of deceased member: Section 30-25

- Section 30-25 now provides that the personal representative of a deceased member may exercise the rights of a transferee and, for purpose of settling the estate, the rights of a member to information under section 10-15.

Formation, reporting, dissolution and termination

a. Articles of organization: Section 5-5

- Subsection (a)(4) includes a statement in the articles that the LLC has a member when the filing is effective.

- This section deletes references to whether the company is member or manager managed because that has no implications now for third parties as regular rules of agency apply for authority issues.

- The requirement in subsection (a)(5) that managers and members having the authority of a manager be disclosed is a requirement of the Secretary of State for transparency purposes. Note other efforts in this regard at national level.

b. Powers: Section 1-30

- Clarifies that managers are designated (vs elected, though they made be elected too) and officers and other agents may be appointed.

c. Dissolution and winding up: Section 35-1

- Generally, prior law rewritten to conform to RULLCA.

- Addition of unanimity for consent of members is only existing default rule and not a substantive change – may be modified by the operating agreement.

- An LLC does not dissolve until 180 days has passed after the company has no members. Consistent with section 10-1 re admission of members. Note section 35-3(c), discussed below.

- Unlawful activity now requires a judicial determination. Illegal or fraudulent behavior by managers or those members in control does not require a showing of harm to the petitioner.

- Failure to purchase the distributional interest and general equity have both been deleted as grounds for dissolution (see deletion of section 35-60 and purchase of interest as a default rule).

- New section 35-1(b) grants a court broad authority to fashion another remedy, including a buyout of petitioner's interest, rather than requiring dissolution.

d. Continuance after dissolution: Section 35-3

- This section has been simplified; no filing is required if members agree to waive the winding up and termination. Substantively, the changes clarify that the ability to waive the right to wind up the company and continue as if it had not dissolved does not apply in judicial or administrative dissolutions (reinstatement is covered in section 35-40).

- The legal representative of the last remaining member may within one year of the event that caused its dissociation agree to continue the LLC and new members maybe admitted as provided.

e. Winding up: Section 35-4

- Winding up is also clarified. Priorities for who controls winding up include: 1) remaining members not wrongfully dissociated, 2) if none, legal rep of last member, 3) if legal rep doesn't, person appointed by transferees.

- When court may order supervision is clarified, including on application by a member with good cause or a transferee if there are no members and no person agrees to wind up business.

f. Agency after termination: Section 35-7

- Section only changed to reflect other changes in section 13-5 (apply agency law will determine a person's authority).

g. Statement of termination: Sections 35-15 and 35-20

- Clarifies that this is really a statement of termination rather than dissolution because it is filing at end of winding up.

- If no filing? Administrative dissolution. Consider authority to transfer property found after filing.

h. Administrative dissolution: Section 35-37

- Limits use of name of an administratively dissolved LLC for three years after issuance of notice of dissolution. Similar to corporate law.

i. Dissociation and effects: Sections 35-45 and 35-55

- Section 35-45 clarifies that a member dissociates if they cease to be a member as a result of a merger or domestication and if they participate in a conversion.

- Section 35-55 clarifies that except when a member dies (which is governed by section 30-25) or participates in a merger, etc., on dissociation a distributional interest is held by the person as a transferee (and has resulting rights).

j. Elimination of buy-out right: Former Sections 35-60 and 35-65

- Default rule for buy-out of a distributional interest on dissociation is eliminated. This change made to reflect expectations of parties strictly as a default matter.

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PANEL DISCUSSION QUESTIONS

Hypothetical 1

Founder started a business many years ago that provides various services to a nationwide, big box store chain similar to Costco ("Customer"). Originally, Founder's business provided products for resale at Customer's stores and eventually expanded to include the operation of dedicated distributions centers to handle all products needed at the stores, real estate acquisition and location services, store build-out and construction, fulfilment of on-line orders, and transportation services for Customer's goods and employees. The business is very successful and is owned through an Illinois, single-member LLC ("Company"). Over the years, Founder recruited a crack management team, who have been with him a long time. They have often asked to buy "stock" in the LLC, but until now he has refused. Now he is considering letting them each buy a 5% interest in the LLC. He has made it clear that he wants nothing to change regarding how the LLC is managed. In other words, though he will continue to let them manage the business on a day-to-day basis, he will make all final decisions as he has in the past. They are fine with this, as they greatly admire him and respect his judgment.

You are counsel for Founder and Company. Founder has instructed you to draft this concept into the operating agreement. Founder is very clear that he wants to be the final decision maker and wants to have no liability for his decisions.

Founder also controls several other businesses that serve Customer, which businesses are owned by him, his son and daughter and certain outside investors. Some of these businesses overlap with the services rendered by Company. Founder has a very strong, personal relationship with the CEO of Customer. Customer is a public company and some of its stores are franchised to owner-operators. The CEO is very sensitive to the feelings of his franchisees and other suppliers. As a result, there often are situations where the CEO asks Founder to handle projects through these side companies, even though Company would be competent to handle them on its own. Even where the CEO does not insist, Founder often uses his judgment to allocate business among these companies if he believes it would be in the best interest of

Customer or might otherwise avoid controversy for the CEO. As counsel, you are fully aware of these facts, as is Founder's management team.

Discuss how you propose to address these issues in the operating agreement. What other issues should be addressed?

Hypothetical 2

Your "client" is a group of business people that want to form a business. They are working together because they each bring relevant skills to running the business. One person has real estate skills and will handle the purchase and sale of real estate. Another person has marketing skill and will deal with advertising and placing ads and the like. Another person will be the office manager and will buy supplies and hire and fire employees. They agree on how they want to make decisions, e.g., by majority vote, but they are struggling with the titles to give one another and the significance of these titles. What advice do you give them?

Hypothetical 3

Same facts as Hypothetical 2. After the business has been operating successfully for 10 years, the real estate member dies. His spouse becomes the owner of his distributional interest but is not admitted as a member. A year later, the company stops making regular cash distributions with no explanation. The spouse is concerned because she had been counting on the distributions to pay her share of the company's income taxes. She received a K-1, but she has not received any financial statements for the past year. She retains you to represent her. What advice to you give her?

Hypothetical 4

Same facts as Hypothetical 2. Five years after the company's formation, the member who had been managing the office began to have serious performance issues. The other members expressed their concerns and the office manager promised to improve, but nothing has changed and his incompetence is beginning to harm the business. In the operating agreement, each member has agreed to perform their services on a full-time basis, but it is silent about termination. The remaining members want to fire him and hire a more competent office manager. What advice to you give them as counsel to the company?

Hypothetical 3

An LLC you have represented for years, which now has 5 members, two of whom are active in the business, will now dissolve and wind up their business. There were 6 members until about 6 months ago, when one of the members passed away. What advice would you give your client regarding winding up the business, selling property, making distributions and filings with the state?

2017 AMENDMENTS TO THE ILLINOIS LIMITED LIABILITY COMPANY ACT: WHAT YOU NEED TO KNOW

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Thursday, April 13, 2017

SEMINAR AGENDA

1. Welcome and introduction of panel by moderator (5 minutes) (Phil Hablutzel)

2. Remarks as to Institute of Illinois Business Law and the work of its LLC Committee (5-10 minutes) (Robin Heiss)

3. Handouts

    - Link to Public Act 099-0637: http://ilga.gov/legislation/publicacts/fulltext.asp?name=099-0637
    - Sectional Summary of Changes to Illinois Limited Liability Company Act
    - Comments to the Amendments to the Illinois Limited Liability Company Act Effective July 1, 2017

4. Substantive topics (15-20 minutes each)

    - Agency (Bud Murdock)
        a. Old agency rules
        b. New rules in 13-5
        c. Statements of authority and denial

    - Informational rights (John Eisel)
        a. Additions to 1-40
        b. New 10-15

    - Other rights and obligations of members and managers (Steve Frost)
        a. Admission, etc. : 10-1
        b. Management, decisions, consent requirements: 15-1
        c. Indemnification and insurance: 15-7
        d. Contributions and distributions: 20-1, 20-5 and 25-35
        e. Personal representative of deceased member: 30-25

    - Operating agreement, including fiduciary duties (Robin Heiss)
        a. 15-3
        b. 15-5

    - Rights and obligations of transferees, dissociated members and creditors (Bud Murdock)
        a. 30-5
        b. 30-10
        c. 30-20

- Changes as to mergers, conversions and domestications: Art. 37 (John Eisel)

- Formation, reporting, dissolution and termination (Steve Frost)

    a. Articles of organization: 5-5
    b. Powers: 1-30
    c. Dissolution and winding up: 35-1
    d. Continuance after dissolution: 35-3
    e. Winding up: 35-4
    f. Agency after termination: 35-7
    g. Statement of termination: 35-15 and 35-20
    h. Administrative dissolution: 35-37
    i. Dissociation and effects: 35-45 and 35-55
    j. Elimination of buy-out right: Former 35-60 and 35-65

- Other miscellaneous changes (Robin Heiss)
    a. Definitions: 1-5
    b. Electronic records and signatures: 1-6 and 55-3
    c. Statute of frauds: 1-46
    d. Governing law: 1-45
    e. Signing of documents: 5-45
    f. Annual reports: 50-1
    g. Fees: 50-10
    h. Construction and application: 55-1
    i. Effective date

5. Panel discussion/Practice Tips (30-45 minutes)

6. Q & A (15 minutes)

2017 AMENDMENTS TO THE ILLINOIS LIMITED LIABILITY COMPANY ACT:
WHAT YOU NEED TO KNOW

Presented by the ISBA Corporation, Securities and Business Law Section Council

Thursday, April 13, 2017

SECTIONAL SUMMARY OF CHANGES TO ILLINOIS LIMITED LIABILITY COMPANY ACT EFFECTIVE JULY 1, 2017

§ 1-5. Definitions.

- Minor definitional changes in Bankruptcy, Company (new), Contribution, Distributional Interest, Legal Representative(new), Manager, Manager-Managed Company, Membership Interest, Operating Agreement, Record (new), Sign (new)

§ 1-6. Electronic records.

- New

§ 1-30. Powers.

- Minor change in (10) as to managers, officers and agents

§ 1-40. Records to be kept.

- New (c). Application of inspection rights to transferees
- New (d). Procedures for demands for inspection

§ 1-46. Applicability of statute of frauds.

- New

§ 1-65. Governing law.

- New

§ 5-5. Articles of organization.

- New requirement as to confirmation of members
- Change in need to list all members
- Minor terminology corrections.

§ 5-45. Forms, execution, acknowledgement and filing.

- Minor changes as to signing of documents

§ 5-47. Statement of correction.

- Non-substantive cleanup

§ 5-50. Amendment or termination by judicial act.

- Minor terminology changes

§ 10-1. Admission of members.

- Clarifies when a person becomes a member.
- Clarifies the rights of a person who acquires a distributional interest but does not become a member.
- Permits admission of member who does not have a distributional interest.

§ 10-15. Right of members and dissociated members to information.

- Substantially revised

§ 13-5. No agency power of a member as member.

- Substantially revised
- Old imputed agency rules are eliminated

§ 13-15. Statement of authority.

- New

§ 13-20. Statement of denial.

- New

§ 15-1. Management of limited liability company.

- New default rule for managerial form of LLCs
- Changes to matters requiring unanimous consent

§ 15-3. General standards of member and manager's conduct

- Clarification in subsection (g)(3)

§ 15-5. Operating agreement

- Addition to subsection (a) as to manager-managed companies
- Substantive changes in subsection (b) to what may not be changed in the operating agreement
- Substantive changes to what may be changed in the operating agreement as regards fiduciary duties
- New provisions regarding enforcement and effective date of the operating agreement and

deemed consent to the operating agreement

§ 15-7. Member and manager's right to reimbursement and indemnification.

- Changed standard for reimbursement of managers and members in (a)
- New provision for insurance in (e).

§ 20-1. Form of contribution.

- Minor wording changes

§ 20-5. Member's liability for contributions

- Minor changes in liability for failure to make agreed contributions
- Permits the operating agreement to provide for a variety of specific remedies for failure to make agreed contributions

§ 25-35. Liability for unlawful distributions

- Substantive changes

§ 30-5. Transfer of a distributional interest.

- Clarification of consequences

§ 30-10. Rights of a transferee

- Clarification of rights of a transferee who does not become a member as to inspection rights
- Change in right of transferee to seek dissolution

§ 30-20. Rights of creditor.

- Substantive clarification of the rights of a creditor under a charging order

§ 30-25. Power of personal representative of deceased member

- New

§ 35-1. Events causing dissolution and winding up of company's business.

- Substantive changes as to events causing dissolution
- Substantive changes regarding the rights of a member, a transferee and a dissociated member to seek judicial dissolution
- New provision authorizing the court to order alternative remedies to dissolution

§ 35-3. Limited liability company continues after dissolution

- Changes as to waiver of right to have company wound up and terminated after an event of dissolution
- New provision for continuance of company that has no members
- Clarification as to administrative dissolutions

§ 35-4. Wind-up of limited liability company's business

- Substantive changes

§ 35-7. Member or manager's power and liability as agent after dissolution.

- Minor deletion

§ 35-15. Statement of termination.

- Changes in terminology and procedures.

§ 35-20. Filing of statement of termination

- Changes in terminology

§ 35-37. Administrative dissolution; limited liability company name

- New

§ 35-45. Events causing member's dissociation.

- Addition of subsections (12), (13) and (14) regarding certain mergers, conversions and domestications.

§ 35-55. Effect of member's dissociation

- Clarifications as to effects
- Deletion of reference to mandatory buy-out

§ 35-60. Company purchase of distributional interest and § 35-65. Court action to determine fair value of distributional interest.

- Mandatory buy-out right eliminated.

Article 37

- Substantially rewritten as to mergers
- New provisions for domestications and conversions.
- Minor wording changes as to series limited liability companies

§ 50-1. Annual reports.

- Change as to obligation to list names and addresses of non-managerial members

§ 50-10. Fees

- Minor changes in terminology
- New fees for new forms

§ 55-1. Construction and application

- Additions as to freedom of contract and other rules of construction

§ 55-3. Relation to Electronic Signatures in Global and National Commerce Act.

- New

Prepared by Robin Heiss

March, 2017

INSTITUTE OF ILLINOIS BUSINESS LAW

COMMENTS TO THE AMENDMENTS TO THE ILLINOIS LIMITED LIABILITY COMPANY ACT EFFECTIVE JULY 1, 2017 (Public Act 099-0737) (The "2017 Amendments")

(805 ILCS 180/1-5)
Sec. 1-5. Definitions.

COMMENTS

The term "distributional interest" is used throughout the Act to refer to the economic rights of a member -- i.e., to receive distributions. The term is not intended to encompass any other rights of a member. The changes in this definition are intended to clarify that concept.

The term "membership interest" or "interest" of a member refers to all of the rights and interests of a member.

The revisions to the definition of "operating agreement" come from the Revised Uniform Limited Liability Company Act ("RULLCA"). The revisions clarify that an operating agreement may be oral insofar as the Illinois Limited Liability Company Act (the "Act" or "ILLCA") is concerned, but other Illinois law (including principles of contractual interpretation and construction, issues of proof and various statutes of frauds) may impact enforceability. For a discussion of these issues, see the Comments to Section 102 (Paragraph 13) of RULLCA. Note, however, new Section 1-46 of the Act, which eliminates the possible application of a portion of the Illinois general statute of frauds to oral operating agreements. See also the Comments to Sections 15-5 and 20-5.

The definition of "record" is borrowed from RULLCA Section 102. It joins together electronic and digital records with writings on paper in a single term, and gives electronic and digital records the same weight and probity in the law as traditional writings on paper. Although the definition comes in this case from RULLCA, it is also used in the Uniform Electronic Transactions Act, the Illinois Electronic Commerce Security Act ("IECSA"), and the federal Electronic Signatures in Global and National Commerce Act. It is now the uniformly accepted definition in the law nationally of a term that recognizes the equivalence between digital and electronic records and those written on paper. See the Comments to Section 55-3. ILLCA was enacted before the question of digital and electronic records was settled in American law and in Illinois. As a result, there are many instances of archaic terminology in ILLCA such as "in writing," "written," and "document". In those sections of ILLCA that are being substantively *amended by the 2017 Amendments, the word "record" replaces these archaic terms. IECSA makes it clear that the uses of the older, more archaic terminology in those sections of ILLCA that are not being substantively amended, automatically include electronic and digital records within the scope of their meaning. See also the Comments to Section 1-6.*

(805 ILCS 180/1-6)
Sec 1-6. Electronic records.

COMMENTS

One of the objectives for amending the Act is to make sure that it is current with respect to the validity and enforcement of electronic records and signatures. In 1999, Illinois adopted IECSA, which establishes the equivalence between electronic and written records in Illinois law. This comprehensive act covers all of Illinois law, and has the effect of making every reference to "written," "in a writing," or anything equivalent, to mean and include, also, electronic records. An electronic record is as enforceable and valid as any writing on paper. New Section 1-6 simply recognizes the effect of IECSA on the Act. It also should serve to counter any argument that a subsequent statute or amendments to a statute subsequent to enactment of IECSA may somehow trump it.

(805 ILCS 180/1-30)
Sec. 1-30. Powers.

COMMENTS

The revision to Subsection 1-30(10) clarifies that a limited liability company may appoint officers, who are of course agents. The use of officers -- frequently conforming to the corporate model -- is a common practice. There is no need for a limited company to have officers or, if it does so, to utilize the titles and duties prevalent for corporations. If officers are desired, it is prudent either that the operating agreement set forth the details for their appointment, removal, titles and duties, or that it clearly delegate to the manager or others the authority to appoint and remove them and to determine their titles, duties, compensation and related details.

(805 ILCS 180/1-40)
Sec. 1-40. Records to be kept.

COMMENTS

Subsection 1-40(c) expands the rights under subsection (b) so that they apply to a transferee of a distributional interest, but only for a proper purpose. A transferee might, for example, request the information in the face of a significant, unexplained decrease in distributions. The concept of a "proper purpose" has been borrowed, in part, from Section 7.75 of the Illinois Business Corporation Act of 1983 (the "BCA").

(805 ILCS 180/1-46)
Sec. 1-46. Applicability of statute of frauds.

COMMENTS

Prior to the 2017 Amendments, the Act was generally understood to permit operating agreements to be oral, although there was some ambiguity as to whether this applied to multi-member operating agreements. See Comments to Section 15-5(c). There was also uncertainty as to whether Illinois' general statute of frauds [740 ILCS 80/2] applied to oral operating agreements which might not be fully performed within one year. New Section 1-46, which is derived from Section 8-113 of the Uniform Commercial Code, is intended to clarify that that portion of the Illinois' general statute of frauds that applies to contracts not capable of performance within one year does not apply to operating agreements. Other portions of the general statute of frauds, however, such as those dealing with contracts of suretyship or the sale of real estate, are unaffected by this section.

The use of oral operating agreements presents obvious risks due to the difficulty of proving (or even ascertaining) their precise terms, and many lawyers counsel against their use. But if they are utilized in reliance on Section 1-5, there is little sense in their being subject to possible unenforceability due to other law.

(805 ILCS 180-65)

Sec. 1-65. Governing law.

COMMENTS

This Section is borrowed from Section 106 of RULLCA. See the Comments thereto as regards the concept of "internal affairs". Note that the applicability of this Section may not be changed in the operating agreement. See Section 15-5(b)(9).

(805 ILCS 180/5-5)
Sec. 5-5. Articles of organization.

COMMENTS

New Subsection 5-5(a)(4) is intended to clarify that a limited liability company must have one or more members <u>at the time of formation</u>. See Section 5-1(b).

New Subsection 5-5(a)(5) follows the modern practice, as reflected in Sections 201 of RULLCA and the ABA Prototype Limited Liability Company Act (the "Prototype Act"), of not requiring the filing of names and addresses of all of the members. Similar changes have been made in Sections 50-1 and 37-40(d).

(805 ILCS 180/5-45)
Sec. 5-45. Forms, execution, acknowledgement and filing.

COMMENTS

The term "sign" is defined in Section 1-5. The term "record" is also defined in Section 1-5 and is intended to be synonymous with the term "document".

Documents filed by a person other than a limited liability company, such as a statement of denial, must be signed by that person. See Section 13-20.

Subsection 5-45(b)(2) contains a special rule for the signing of certain documents in connection with dissolution and winding up.

Subsection 5-45(e) should be read in light of Sections 1-5 and 5-46.

(805 ILCS 180/5-47)
Sec. 5-47. Statement of correction.

COMMENTS

Existing Subsections 5-47(e)(4) through (6) have been deleted in light of RULLCA Section 206, which contains no list of <u>types</u> of changes (such as the company name or purpose) that cannot be corrected in a statement of correction. However, as stated in subsection 5-47(a), the correction must relate to something in a filed instrument that was in fact erroneous or defective at the time it was filed. A statement of correction may not be used to correct something that was substantively correct at the time the instrument was filed; such a change would require an amendment to the original instrument.

(805 ILCS 180/10-1)
Sec. 10-1. Admission of members.

COMMENTS

Section 10-1 has been expanded to clarify when a person becomes a member of a limited liability company. Subsection (a)(1) provides clarification, lacking under prior law, as to when a person becomes a member upon formation of a company. Subsection (a)(2)(D) provides a mechanism for *the designation of a person as a member of a company that has had no members for 180 consecutive days. Without such a mechanism, such a company might be unable to complete its winding up process. Subsection (b) clarifies that a person that acquires a distributional interest but is not admitted as member has merely the rights of a transferee, whose rights are governed by Section 30-10. Subsection (c) authorizes a person to become a member without having a distributional interest or being obligated to make a contribution to the company. This provides flexibility to permit third parties to exercise control over a company in which they have no direct economic interest. These provisions come largely from RULLCA.*

(805 ILCS 180/10-15)
Sec. 10-15. Right of members and dissociated members to information.

COMMENTS

Subsection (a) is new to ILLCA and borrows heavily from RULLCA. It clarifies existing law by explicitly stating what information members are entitled to receive from the company. However, that right exists only to the extent the information is "necessary to the proper exercise of a member's rights and duties under the operating agreement or this Act or that is otherwise material to the membership interest of a member".

The term "record" is defined in Section 1-5 and is taken from RULLCA.

Whenever a member is being asked to consent to a matter, subsection (c) imposes an affirmative obligation on each limited liability company to disclose all information known to the company that is material to the member's decision. The subsection is taken verbatim from RULLCA. Although this obligation is partly implicit in subsection (a), there is no limit in subsection (c) on the kind of information that must be disclosed.

Subsection (d) extends the right to information to dissociated members as long as the information in question pertains to the period during which the person was a member and is being sought in good faith. Under subsection (g), the right to information does not extend to transferees.

Subsection (h) permits the company to impose reasonable conditions and restrictions on the members' access to and use of such information. This subsection recognizes, among other things, that many companies are bound by confidentiality agreements with customers, suppliers and other parties, which agreements typically prohibit disclosure unless each person to which the covered information is disclosed executes an agreement not to further disclose the information. The subsection also recognizes that the disclosure of trade secrets could cause them to be lost. It is intended that these conditions and restrictions may be imposed only if they are imposed in the ordinary course of the company's activities.

Subsection (i) clarifies that this section does not limit or restrict the right to inspect and copy records as provided in existing Section 1-40. The latter section defines certain basic records which each member is entitled to inspect and copy without stating a reason or having a particular purpose.

No change is being made to Section 15-5(b)(1), which limits the extent to which Section 10-15 may be modified in the operating agreement.

(805 ILCS 180/13-5)
Sec. 13-5. No agency power of a member as member.

COMMENTS

New Sections 13-5, 13-15 and 13-20 are borrowed almost verbatim from RULLCA and supersede existing Section 13-5. Existing Section 13-5 incorporated what has become known as the concept of statutory apparent authority. This concept has been criticized because there was no way to limit the apparent authority of anyl member (in a member-managed entity) or any manager (in a manager-managed entity). This concept is grounded in partnership law, and arguably undermines the ability of modern limited liability companies to manage their affairs flexibly and consistently with current practice. New Section 13-5 eliminates this concept, and looks solely to "other law, including the law of agency" (including the rules of apparent authority) to determine who is an agent.

See the Comments to RULLCA Section 301 for background and discussion of these changes.

Sec. 13-15. Statement of authority.

COMMENTS

Section 13-15 is new to the Act, but a parallel provision is currently found in the Illinois Uniform Partnership Act (see Section 206/303). Section 13-15 permits a company to define the authority of its members or managers in a publicly filed document called a statement of authority. A grant of authority set forth in a statement of authority is conclusive on a third party that is not a member and that gives value in reliance on the grant, except to the extent the person had knowledge to the contrary at the time value was given. A statement of authority containing a limitation of authority (as opposed to a grant) is not by itself evidence of knowledge or notice of the limitation by any person (except for a limitation on authority to transfer real property contained in a statement of authority that has been filed in the office of the recorder of deeds -- an exception which is consistent with current Illinois law).

Subsection 13-15(h) covers the possibility that the articles of organization may also contain a grant or a limitation on a grant of authority, although the effect of such provisions is not clear under existing law. Under Subsection (h), such provisions are not binding on third parties unless they receive actual notice thereof from the company. If such provisions conflict with a grant or a limitation on a grant of authority in a statement of authority, the latter prevails.

(805 ILCS 180/13-20)
Sec. 13-20. Statement of denial.

COMMENTS

This section has been taken from Sections 303 and 302(k) of RULLCA.

(805 ILCS 180/15-1)
Sec. 15-1. Management of limited liability company.

COMMENTS

Section 15-1(a), which is new, provides that whether a company is manager-managed is determined solely by the operating agreement. In the absence of such a provision, a company is member-managed. The obligation to specify in the articles of organization whether the company is manager-managed or member-managed, as provided in existing Section 5-5, is being eliminated.

Although the distinction between manager-managed and member-managed entities will be preserved in the statute for certain limited purposes, it will be eliminated for other purposes. For example, it will no longer automatically determine who is an agent of the company (see changes to Section 13-5 and the comments thereto). The intent is to provide greater flexibility to each company to determine its management structure in its operating agreement, including the ability to adopt "hybrid" structures.

(805 ILCS 180/15-3)
Sec. 15-3. General standards of member and manager's conduct.

COMMENTS

The basic default rules on fiduciary duties as provided in this section will remain unchanged. See, however, the changes to Section 15.5.

(805 ILCS 180/15-5)
Sec. 15-5. Operating agreement.

COMMENTS

These changes are borrowed heavily from RULLCA. They reflect a modern trend of giving each company greater freedom of contract in its operating agreement, including flexibility with respect to fiduciary duties. However, consistent with the notion that there should be certain fundamental protections, this flexibility is not unlimited.

See comments to Section 35-60 with respect to the deletion in Section 15-5(b)(5).

The reference to the obligation of good faith and fair dealing in Section 15-5(b)(7) should be understood in light of the language of Section 15-3 and current case law. The obligation of good faith and fair dealing does not create a separate, *independent fiduciary duty; rather, it is an implied contractual covenant that is used as a tool for construing and applying terms of a contract. Abbott v. Amoco Oil Co., 619 N.E.2d 789, 795-797 (Ill. App. Ct. 2d Dist. 1993). When a contract is clear, the implied covenant is not relevant to interpret the intent of the parties. Id. Illinois courts have recognized an implied covenant in contracts when a party to the contract has discretion in performance that "[g]ood faith between contracting parties requires one vested with contractual discretion to exercise it reasonably and not arbitrarily or capriciously." Vincent v. Doebert, 539 N.E.2d 856, 862 Ill. App. Ct. 2d Dist. 1989). A recent case in Delaware that analyzes a similar application of the implied covenant and is instructive is Nemec v. Shrader, 991 A.2d 1120 (Del. 2010). See the Comments to RULLCA Section 409(d).*

Existing Subsection 15-5(c) contains rules applicable to operating agreements for single member limited liability companies. By implication, they raised questions as to the enforceability of oral operating agreements for multiple-member companies. These rules have been eliminated in view of the revised definition of operating agreement in Section 1-5. See the Comments to that Section.

New Section 15-5(c) permits the duty of loyalty to be restricted or eliminated, as further described below, while preserving the company's ability to identify specific types or categories of activities that do not violate any fiduciary duty. It also permits the alteration of the duty of care, except for intentional misconduct or knowing violation of law.

New Subsection 15-5(c)(1) permits the operating agreement to restrict or eliminate a fiduciary duty (other than the duty of care described in Section 15-3(c)), provided that the restriction or elimination is clear and unambiguous. The test and reason for the application of this concept is set forth clearly in Miller v American Real Estate Partners, L.P., Civ. A. No. 16788, 2001 WL 1045643, at 8, (Del. Ch. Sept. 6, 2001), where the court, citing an earlier Delaware decision concluded "[b]ut just as investors must use due care, so must the drafter of a partnership agreement who wishes to supplant the operation of traditional fiduciary duties. In view of the great freedom afforded to such drafters and the reality that most publicly traded limited partnerships are governed by agreements drafted exclusively by the original general partner, it is fair to expect that restrictions on fiduciary duties be set forth clearly and unambiguously. A topic as important as this should not be addressed coyly." In another Delaware decision, the court noted that "[p]rinciples of contract preempt fiduciary principles where the parties to a limited partnership have made their intentions to do so plain." Sonet v. Timber Co., L.P., Del. Ch., 722 A.2d 319, 322 (Del. Ch. 1998).

New Section 15-5(d) permits the company to devise procedures in the operating agreement to authorize or ratify acts which might otherwise violate the duty of loyalty. Such authority must be exercised by disinterested and independent persons after full disclosure of all material facts.

New Section 15-5(e) provides a parallel right to eliminate or limit a member or manager's right to payment or reimbursement under Section 15-7 and its liability to the company for money damages, in each case subject to five express exceptions.

New Section 15-5(g) clarifies that a person who becomes a member is deemed to assent to the operating agreement, whether or not that person actually signs the agreement.

New Section 15-5(h) clarifies that the operating agreement may be entered into before, after or at the time of formation and may be made effective as of the time of formation. Note, however, that under Sections 5-1(b) and 5-5(a)(4), a company must have at least one member at the time of formation.

(805 ILCS 180/20-5)
Sec. 20-5. Member's liability for contributions.

COMMENTS

The last sentence of Subsection 20-5(c) clarifies that the remedy of specific performance is available in appropriate cases for the failure of a member to make agreed contributions. The sentence is not intended to limit the equitable requirements for such a remedy. It also acknowledges, as further provided in Subsection 20-5(e), that many operating agreements provide other remedies or consequences for failure to make contributions. The illustrative list of remedies or consequences in Subsection 20-5(e) is implicit, because under Section 15-5, there are no restrictions on what the operating agreement may contain other than those listed in Subsection 15-5(b). Nonetheless, other state limited liability company statues have comparable provisions, and their inclusion here is intended merely for emphasis and clarification. See, e.g., Section 18-502(a) of the Delaware Limited Liability Company Act (the "Delaware LLCA"); Section 502(a) of the New York Limited Liability Company Law (the "New York LLCL"). As with any contractual provisions, they are subject to general contract law and equitable principles. See Section 1-43.

Some state limited liability statutes and the Prototype Act require that promises to make contributions must be in writing. See, e.g., Section 7-80-502(3) of the Colorado Limited Liability Company Act; Section 608.4211(2) of the Florida Limited Liability Company Act; Section 403 of the Prototype Act. Without limiting any provisions of Illinois law outside of ILLCA, there is no such requirement in ILLCA. There are, however, obvious risks to oral operating agreements.

Some state limited liability statutes state that a conditional obligation of a member may not be enforced unless the conditions of the obligation have been satisfied or waived. See, e.g., Section 18-502(b) of the Delaware LLCA; Section 502(b) of New York LLCL. Because that is just one of many possible contractual provisions that could give rise to issues of contractual construction and interpretation, it was not included in the 2017 Amendments and no inference should be drawn from its omission.

(805 ILCS 180/25-35)
Sec. 25-35. Liability for unlawful distributions.

COMMENTS

The revisions in Subsections 25-35(a) and (d) are for clarification only.

Subsections 25-35(b) and (c) provide two ways that a person can avoid liability by having consented to an unlawful distribution. These are common sense exceptions

ARTICLE 30. TRANSFER OF DISTRIBUTIONAL INTERESTS

COMMENTS

The new title to Article 30 is more logical because Article 30 uses the term distributional interests rather than membership interests and uses the term transfer rather than assignment.

(805 ILCS 180/30-5)
Sec. 30-5. Transfer of a distributional interest.

COMMENTS

New Section 30-5(a) was added to clarify the important rule that a transfer of a distributional interest does not affect the existence of the company.

(805 ILCS 180/30-10)
Sec. 30-10. Rights of a transferee.

COMMENTS

See comments to Section 35-1.

Distributions to which a transferee who does not become a member may be entitled could be subject to offset. See Comment to RULLCA Section 502(b).

(805 ILCS 180/30-20)
Sec. 30-20. Rights of creditor.

COMMENTS

These changes are intended to clarify that a judgment creditor may assert its rights only through a charging order; that a charging order is merely a lien, entitling the judgment creditor to only the distribution rights (but no other rights) of the judgment debtor; that the court is empowered to appoint a receiver to receive the distributions and to make such inquiries as the judgment debtor might have made; that the lien may be foreclosed in order to permit the distributional interest to be sold; that a buyer at such a foreclosure sale does not thereby become a member; that the judgment debtor may extinguish the charging order by satisfying the judgment at any time before the sale; that *the company or any other member or members may acquire the distributional interest by satisfying the judgment at any time before the sale; and that this section provides the exclusive remedy to which a judgment creditor is entitled with respect to an interest in an LLC. This section is intended to protect the LLC and the other members from any other rights or remedies that a judgment creditor might seek under other law.*

This Section is based on RULLCA Section 503.

(805 ILCS 180/30-25)
Sec. 30-25. Power of personal representative of deceased member.

COMMENTS

This Section is taken from RULLCA Section 504.

(805 ILCS 180/35-1)
Sec. 35-1. Events causing dissolution and winding up of company's business.

COMMENTS

This section has been reorganized and clarified based on RULLCA.

New Section 35-1(a) is not intended to modify Section 35-3.

The change to Existing Subsection 35-1(2), which comes from RULLCA, is consistent with certain other sections that require unanimity of the members as a default rule. Because it is a default rule, the requirement can, of course, be changed in the operating agreement. The existing language would not have worked in the case where no vote was specified for dissolution in the operating agreement.

Existing Subsection 35-1(3) has been replaced by new Subsection 35-1(a)(4)(B), which also comes from RULLCA. Because the presence of illegal activity might not be readily apparent and could lead to the inadvertent dissolution of a company, it was felt that any dissolution based on illegality should require a judicial decree.

Existing Subsection 35-1(4)(E) has been replaced by new Subsection 35-1(a)(5)(A). As revised, Subsection 35-1 (a)(5) provides that the existence of illegality or fraud should not necessarily require a showing of harm to the petitioning member, but the existence of oppression should. In addition, the right to seek dissolution based on illegality, fraud or oppression does not accrue to a dissociated member. These changes are also found in RULLCA.

The ability of a transferee to wind up the company on equitable grounds under existing Subsection 35-1(5) has been eliminated. This right was not consistent with the Section 30-10, which provides that a transferee receives only a distributional interest, and not any other rights of the transferring member. The change is also consistent with RULLCA.

New Subsection 35-1(b), also based on RULLCA, gives the court the authority to craft a remedy other than dissolution where the circumstances do not warrant it. The concept is reminiscent of the alternative remedies listed in Section 12.56 of the BCA, but provides greater latitude to the court. It is expected that in determining whether to award alternative remedies, the court will be informed by BCA Section 12.56 but will not be constrained by it. The absence of a listing of possible alternative remedies in new Subsection 35-1(b) is not intended to limit the equitable powers of the court.

(805 ILCS 180/35-3)
Sec. 35-3. Limited liability company continues after dissolution.

COMMENTS

Existing Subsection 35-3(c) has been simplified. Consistently with new Subsection 15-5(b)(3), new Subsection 35-3(d) clarifies that the right to revoke dissolution under this section does not apply to judicial or administrative dissolutions. Except as provided in Subsection 15-5(b)(3) and Subsection 35-3(d), Section 35-3 is a default rule, and a limited liability company is free to provide other rules, procedures and time-frames for revocation of a dissolution.

(805 ILCS 180/35-4)
Sec. 35-4. Wind up of limited liability company's business.

COMMENTS

The amendments to this Section derive from Section 702 of RULLCA. Subsection 35-4(c) now distinguishes between steps that are mandatory as opposed to permissive. The other amendments are intended to fill potential gaps in the existing statute rather than change existing law.

Normally, winding up is conducted by the manager or those members having the authority of a manager. They are protected from liability for the debts of the company by Section 10-10. Subsections 35-4(b) and (d) clarify that if the winding up is being conducted by a legal representative or appointee, such person has the authority of a sole manager and it too has the benefit of the liability shell under Subsection 10-10(a).

(805 ILCS 180/35-15)
Sec. 35-15. Statement of termination.

COMMENTS

Revised Section 35-15 is based in part on RULLCA Section 702. The term "articles of dissolution" has been replaced by "statement of termination" to more accurately indicate the purpose of the filing. When a limited liability company is dissolved, it continues to exist for purposes of winding up. It also must continue to file annual reports. Filing a statement of termination terminates the company's existence and its responsibility for future annual reports and filing fees. It enables the Secretary of State to change its records accordingly.

(805 ILCS 180/35-37)
Sec. 35-37. Administrative dissolution; limited liability company name.

COMMENTS

This section is substantially identical to BCA Section 12.43.

(805 ILCS 180/35-45)
Sec. 35-45. Events causing member's dissociation.

COMMENTS

Subsections (12), (13) and (14) come from RULLCA and clarify when a member becomes dissociated in a merger, conversion or domestication. See Article 37 and the accompanying Comments.

(805 ILCS 180/35-55)
Sec. 35-55. Effect of member's dissociation.

COMMENTS

New Subsection 35-55(a) eliminates the reference to the buy-out right. See Comments to Section 35-60.

The rest of the additions derive from RULLCA Section 603.

New Subsection 35-55(a)(4) assumes that the dissociated member continues to hold a distributional interest and that the member did not become dissociated by (for example) transferring its distributional interest to a third party. In such a case, the subsection should not be read to give the dissociated member the rights of a transferee.

(805 ILCS 180/35-60)
Sec. 35-60. Company purchase of distributional interest.

COMMENTS

The so-called buy-out right provided in this Section and in Section 35-65 has been eliminated. Originally, it applied to both member-managed and manager-managed companies, but later was limited to member-managed entities. Under current law, the buy-out right gives a member in a member-managed company the right to liquidate its interest at any time -- a right that is not common for other types of business entities or even to other state LLC statues. Any triggering of the buy-out right could cause serious financial problems for the company and might be disastrous if not planned for carefully in advance. Although the buy-out right can be eliminated in the operating agreement, it continues to be a trap for the unwary. The repeal of this section does not mean that such a right cannot be written into the operating agreement.

(805 ILCS 180/35-65)
Sec. 35-65. Court action to determine fair value of distributional interest.

COMMENTS

See Comments to Section 35-60.

(805 ILCS 180/35-70

Sec. 35-70. Dissociated member's power to bind limited liability company.

COMMENTS

In view of the deletion of the imputed agency rules (see the changes to Section 13-5), Section 35-70 no longer serves any purpose. Furthermore, the two-year survival period was somewhat arbitrary. Agency law and the applicable statute of limitations should determine when, if, and for how long, an LLC is bound by the acts of a member. Accordingly, this section is repealed.

ARTICLE 37. CONVERSIONS, DOMESTICATIONS, MERGERS, AND SERIES

COMMENTS

Existing Sections 37-5 through 37-30 of Article 37 have been completely revised in light of RULLCA. New Sections 37-10 through 37-17 significantly expand the ability of an Illinois or foreign organization to convert to a limited liability company, and vice-versa, if the organization's governing statute authorizes the conversion. Previously, the ability to convert was limited to partnerships and limited partnerships. This expansion is particularly important for corporations. Previously, there was no statutory authority in ILLCA for the conversion of corporations into companies or of companies into corporations. At this time, the Illinois Business Corporation Act and the Illinois Not-for-Profit Business Corporation Act have not yet been amended to authorize such conversion, but such amendments have been proposed to the Illinois legislature.

The other type of inter-organizational transaction that is now permitted for the first time in Illinois is domestication. Through domestication, a foreign company can become an Illinois company, and an Illinois company can become a foreign company, through a simple statutory process. Under prior law, domestication would have been possible only via a merger, which is a more cumbersome procedure. Domestication is governed by Articles 37-31 through 37-34. As with conversion, the governing statute of the organization in question must authorize the domestication.

Sections 37-20 thorough 37-30 governing mergers have been amended in conformity with RULLCA to provide consistency of documentation and terminology among the three types of transactions permitted by Article 37. There are few, if any, substantive changes to the sections governing mergers.

Section 37-5 contains a revised and expanded set of definitions of terms used in Article 37.

Section 37-36 provides a special rule for the approval of mergers and conversions by a member who will have personal liability with respect to a surviving or converted organization.

(805 ILCS 180/40)
Sec. 37-40. Series of members, managers or limited liability company interests.

COMMENTS

See Comments to Section 5-5.

(805 ILCS 180/50-1)
Sec. 50-1. Annual reports.

COMMENTS

See Comments to Section 5-5.

(805 ILCS 180/50-10)
Sec. 50-10. Fees.

COMMENTS

See Comments to Section 5-5.

(805 ILCS 180/55-1)
Sec. 55-1. Construction and application.

COMMENTS

With minor changes, Subsection 55-1(b) is taken from the Delaware LLCA and the Prototype Act and Subsections 55-1(c) and (d) are taken from the Prototype Act.

Subsection 55-1(b) states as a policy a concept that was implicit prior to the 2017 Amendments, namely, that there are no limits on what the operating agreement may provide, except as listed in Subsection 15-5(b). Unlike LLCs, corporations are governed by strict statutory rules and many years of case law. LLC's are more akin to partnerships and limited partnerships, which are largely governed by contracts. Subsection 55-1(b) should put to rest any argument that operating agreements should be construed or enforced in a manner that might be appropriate for contracts governing corporations.

(805/ILCA 180/55-3
Sec 55-3. Relation to electronic signatures in global and national commerce act.

COMMENTS

In 2000, Congress enacted the "Electronic Signatures in Global and National Commerce Act" ("E-Sign") to eliminate any statute of frauds problem as a result of the digital revolution in American law. This followed the Uniform Electronic Transactions Act ("UETA") promulgated by the Uniform Law Commissioners in 1999. Some individual states, like Illinois, enacted similar legislation. The Illinois statute is the Electronic Commerce Security Act ("IECSA"), 5/ILCS 175/Art. 1 to Art. 99, which became effective in 1999.

As digital transactions, in which the evidence of signatures and records in electronic or digital form, became common, the many requirements in American law for a "writing"' or for records, agreements and other documents to be written on paper, as evidence of a transaction, event, transfer or notification, were recognized as obsolete and obstructive. But ferreting through the law at federal and state levels to obtain the recognition of digital records and signatures, statute by statute, was understood to be a monumental, virtually unachievable task in any reasonable time frame with available resources. A shortcut had to be found.

Illinois assumed a pioneering role when it enacted IECSA in 1999. The State Legislature appointed a special commission to draft it. In the meantime, the Uniform Law Commissioners promulgated UETA (now law in 49 states), which helped refine and settle the now-widely-accepted rules equating electronic records and signatures with writings on paper. Much cross-fertilization took place between the various efforts, which resulted in substantial similarities between IECSA, UETA and, finally, E-Sign.

However, some digital commerce interests did not want to wait for all states to enact UETA or its equivalent. Congress had to address federal law, but the development of E-Sign veered in the direction of overcoming all statute of frauds problems in state law as well.

As a result, E-Sign has express preemption provisions in 15 U.S.C. § 7002. All state law modifying, limiting or superseding section 7001 (the basic rule in E-Sign equating electronic records and signatures to those written on paper) is preempted. This means that any requirement for a writing on paper in state law cannot be used to exclude an electronic record or signature. E-Sign, however, also allows exceptions to this rule. If a state enacts UETA per se, its law is not preempted. Other state law on use or acceptance of electronic signatures or electronic records also avoids preemption if enacted or adopted in conformity with E-sign. In addition, every state statute providing for electronic records and signatures enacted after June 30, 2000 must expressly refer to E-Sign to show intent to avoid preemption.

To meet this requirement, the Uniform Law Commissioners developed the language that is presented above as Section 55-3 of the Act. This language is standard *(boiler-plate) in every uniform and model act promulgated by the Uniform Law Commissioners since 2000. It uses the language of 15 U.S.C. §7002, virtually verbatim, recognizing E-Sign as Section 7002 requires, while reciting the limitations in state law that the federal statute requires. It thus provides an express shield against any preemption claim.*

The 2017Amendments – in particular, the addition of the definitions of "record" and "sign" in Section 1-5 – confirm the recognition of electronic signatures and records in accordance with Illinois law and E-Sign. The further addition of RULLCA 1102 as Section 55-3 of the Act simply preserves Illinois law, as so amended, avoiding any possible confusion over the impact of federal law.

Prepared by Robin Heiss, John McCabe and John Eisel for the Institute of Illinois Business Law.

March 2017.

2017 AMENDMENTS TO THE ILLINOIS LIMITED LIABILITY COMPANY ACT:

WHAT YOU NEED TO KNOW

Presented by the ISBA Corporation, Securities and Business Law Section Council

Thursday, April 13, 2017

TOPICS:

- **THE OPERATING AGREEMENT, INCLUDING FIDUCIARY DUTIES**
- **MISCELLANEOUS CHANGES**

PREPARED BY ROBIN HEISS

THE OPERATING AGREEMENT, INCLUDING FIDUCIARY DUTIES

BACKGROUND

- The operating agreement is the key document for an Illinois limited liability company ("company" or "LLC") and its members and managers. Its purpose is "to regulate the affairs of the company and the conduct of its business and to govern relations among the members, managers and company." Section 15-5(a).
- Although the operating agreement may be oral, its primacy for determining the rights and obligations of the members and managers suggests that it should be written; should be tailor made for each limited liability company and not merely a "one size fits all" form; and should be revisited from time to time to take into account changed circumstances.
- The operating agreement is a contract and is binding on all members who sign it or are bound by it by being admitted as members.
- Like all contracts, the operating agreement is subject to contractual principles of construction. For example, if the members routinely follow a different rule or practice from that specified in the operating agreement, they may be deemed to have orally modified the operating agreement.
- The Illinois Limited Liability Company Act (the "Act") contains a number of default rules that apply unless changed in the operating agreement. For example, Section 15-1(b)(1) provides that in a member-managed company, "each member has equal rights in the management and conduct of the company's business". As another example, Section 25-1(a) provides that interim distributions to the members "must be in equal shares". It is probable that most companies would wish to change those default rules in their operating agreements.
- This concept of default rules is confirmed in Section 15-5(a): "To the extent the operating agreement does not otherwise provide, this Act governs relations among the members, managers, and company."
- There are, however, a number of things that may <u>not</u> be changed in the operating agreement. These are listed in Section 15-5(b).
- A central part of the Act deals with fiduciary duties. The fiduciary duties of members and managers are set out in Section 15-3. There are two fiduciary duties described in Section 15-3:
    - The so-called duty of loyalty which essentially requires the member or manager (1) to account for any property, property or benefit that belongs to the company, including a company opportunity; (2) to act fairly when a member or manager deals with the company in the conduct or winding up the business as or

    on behalf of a party having an interest adverse to the company; and (3) to refrain from competing with the company in the conduct of the company's business.
  - The so-called duty of care, which requires the member or manager, in the conduct or winding up of the Company's business, to refrain from engaging in grossly negligent or reckless conduct, intentional misconduct, or knowing violation of law.
- There is an over-arching obligation contained in Subsection 15-3(d) that these duties must be discharged and any rights exercised "consistent with the obligation of good faith and fair dealing." This obligation is not a separate fiduciary duty. It is more like a principle to be employed by the courts in construing the operating agreement.

WHAT'S CHANGED

- Oral operating agreements
  - The existing Act is somewhat ambiguous as to whether the operating agreement may be oral. Nowhere does it expressly require a written operating agreement. However, existing Section 15-5(c) states that in a single-member company that has a manager other than the single member, the operating agreement includes any "agreement, which need not be in writing, between the member and the company as to a company's affairs". By negative implication, this language could be interpreted to authorize oral operating agreements only for single-member companies.
  - The 2017 Amendments make it clear that oral operating agreements are permitted. The following sections are relevant:
    - As amended, Section 1-5 defines "operating agreement" as "the agreement under Section 15-5, whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all of the members of a limited liability company, including a sole member".
    - New Section 1-46 removes the operating agreement from the ambit of a portion of the general statute of frauds in Illinois, as discussed further below..
    - Subsection 15-5(c), quoted above, which had raised the ambiguity about oral agreements for multiple-member companies, has been repealed.
  - Despite this, oral operating agreements are risky and are not generally recommended.

- Most of the important changes affecting the operating agreement have to do with what may <u>not</u> be changed in the operating agreement. These are listed in Section 15-5(b) and itemized below.

- Informational rights
  - Per Subsection 15-5(b)(1), the operating agreement may not "unreasonably restrict a right to information or access to records under Section 10-15". This has been expanded to include Section 1-40.

- Buy-out right
  - As discussed separately, the buy-out right in Sections 35-60 and 35-65 has been eliminated. Section 15-5(b)(5) has been amended to eliminate the reference to the buy-out right.

- Fiduciary duties
  - Existing Subsection 15-5(b)(6) states that the operating agreement <u>may not</u> eliminate or reduce a member's fiduciary duties, but may "(A) identify specific types or categories of activities that do not violate these duties, if not manifestly unreasonable; and (B) specify the number or percentage of members or disinterested managers that may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate these duties."
  - This language has been replaced with new Subsection 15-5(c), which says that the operating agreement <u>may</u> "(1) restrict or eliminate a fiduciary duty, other than the duty of care . . ., but only to the extent the restriction or elimination in the operating agreement is clear and unambiguous; (2) identify specific types or categories of activities that do not violate any fiduciary duty; and (3) alter the duty of care, except to authorize intentional misconduct or knowing violation of law."
  - As a result, the operating agreement may eliminate or restrict the duty of loyalty if the language is "clear and unambiguous". This ability to vary the duty of loyalty was felt to be important in situations where conflicts of interest were unavoidable or expected. The "clear and unambiguous" condition was felt to be a reasonable safeguard, along with the over-arching obligation of good faith and fair dealing. This change is far more modest than the current Delaware LLC Act, which purports to allow the elimination of all fiduciary duties.
  - The operating agreement may still identify specific types or categories of activities that do not violate any fiduciary duty, but there is no longer a requirement that they not be manifestly unreasonable. This requirement seemed to be an ambiguous and unworkable standard.

- In addition, there is a new ability to modify the duty of care, except to authorize intentional misconduct or knowing violation of law.
- Subsection 15-5(b)(7) continues to prohibit the operating agreement from eliminating or reducing the obligation of good faith and fair dealing, but permits the operating agreement to determine the standards by which the performance of the member's duties or the exercise of the member's rights is to be measured. Again, the condition that the standards not be manifestly unreasonable has been eliminated.

- New prohibitions. Under the 2017 Amendments, the operating agreement may not:
  - Eliminate or modify the rule in Section 13-15(h) that creates priority of a statement of authority over the articles of organization. Subsection 15-5(b)(8).
  - Vary the governing law provisions of Section 1-65. Subsection 15-5(b)(9).
  - Vary the power of the court under Section 5-50 to enforce certain amendments or dissolutions. Section 15-5(b)(10).
  - Restrict the right of a members to approve a merger, conversion or domestication if that member will have personal liability as a result. Section 15-5(b)(11).

- Ability to ratify a violation of the duty of loyalty.
  - New Subsection 15-5((d) permits the operating agreement to "specify a method by which a specific act or transaction that would otherwise violate the duty of loyalty may be authorized or ratified by one or more disinterested and independent persons after full disclosure of all material facts." This wording is a bit different than existing Section 15-5(b)(6)(B) quoted above.

- Ability to pay or indemnify a member or manager for certain obligations.
  - New Section 15-7 permits a company to reimburse a member or manager for payments made and indemnify a member or manager for obligations incurred in the course of his or her activities on behalf of the company, if in making the payment or incurring the obligation he or she complied with his or her fiduciary duties. New Subsection 15-5(e) permits the operating agreement to alter or eliminate this right under Section 15-7 (i.e., to modify the fiduciary duty compliance requirement) or to eliminate or limit a member or manager's liability to the company and the members for money damages (exculpation), except for:
    - A breach of the duty of loyalty, unless authorized under Subsections 15-5(c) or (d).
    - A financial benefit received by the member or manager to which he or she is not entitled.

    - A breach of a duty under Section 25-35, which deals with receipt of unlawful distributions.
    - Intentional infliction of harm on the company or a member.
    - An intentional violation of criminal law.

- Other new provisions.
  - Under new Subsection 15-5(f), a company is bound by the operating agreement and may enforce it, whether or not it manifested assent to it.
  - Under new Subsection 15-5(g), a person that becomes a member of a company is bound by the operating agreement whether or not he or she has manifested assent to it.
  - New Subsection 15-5(h) provides that an operating agreement may be entered into before, after or at the time of formation of a company and may be made effective either at the time of formation or as of the time or date provided in the operating agreement.

OTHER MISCELLANEOUS CHANGES

DEFINITIONS

- Various definitions in Section 1-5 have been changed. Listed below are the more important changes:
- "Distributional interest" means "a member's right to receive distributions of the company's assets, but no other rights or interests of a member." The last clause was added. Almost all of the references in the Act to a member's interest in the company utilize the term "distributional interest".
- "Legal representative" is given a definition for the first time. The definition is conventional.
- "Manager" means a person who is vested with authority "in an operating agreement as provided in Section 15-1". Under the 2017 Amendments, a company is member-managed unless otherwise specified in the operating agreement.
- The definition of "manager-managed company" is changed to require that the authority of a manager be vested in the operating agreement, rather than in the articles of organization.
- The definition of "operating agreement" is revised by adding the words "whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all of the members of the limited liability company, including a sole member" to the definition. Thus, an operating agreement is one which concerns the relations among the members, managers, and the company; it need not be written

or expressly called an operating agreement. The terms of an operating agreement may be found in more one or more documents or courses of conduct that demonstrate that the members have agreed to abide by them.

- "Record" is a new definition that helps to clarify that much information these days exists or is communicated in electronic form. A record means "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form." This definition is borrowed from the Revised Uniform Limited Liability Company Act ("RULLCA") but is also found in federal and state statutes that recognize the equivalence between digital and electronic records and written records. The term "record" is used where language has been added to the Act. Older references in the Act to "written" have not been changed, but are deemed to refer to a record. See the next topic below.
- "Sign" is another new definition that was added in recognition of electronic signatures. It means "with the present intent to authenticate or adopt a record: (1) to execute or adopt a tangible symbol; or (2) to attach to or logically associate with the record an electronic symbol, sound, or process."

<u>ELECTRONIC RECORDS AND SIGNATURES</u>

- Two new sections have been added dealing with electronic records.
- Section 1-6 provides that any "requirement in this Act that there be a writing or that any document, instrument, or agreement be written or in ink is subject to the provisions of the Electronic Commerce Security Act." Information about the content of that statute and related statutes can be found in the Comments to the 2017 Amendments to the Illinois Limited Liability Company Act (the "Comments") which accompany these materials.
- Section 55-3 is entitled "Relation to Electronic Signatures in Global and National Commerce Acts." It covers the relationship among the Act and various federal statutes. The intent of this section is to confirm the recognition of electronic signatures and records in accordance with the Illinois Electronic Commerce Security Act. The history and purpose of this section is explained in detail in the Comments.

<u>STATUTE OF FRAUDS</u>

- New Section 1-46 is designed to avoid a statute of frauds problem with oral operating agreements. It states that an "operating agreement is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the agreement is not capable of performance within one year of its making."

- Note that there are other statutes of frauds, such as those dealing with real property, that are not affected by this section.

GOVERNING LAW

- New Section 1-65 is intended to prevent the operating agreement of an Illinois company from choosing the law of another state as its governing law, at least as to certain aspects of its affairs.
- Section 1-65(1) provides that Illinois law governs the internal affairs and organization of a limited liability company. The concept of internal affairs was developed in cases dealing with corporations.
- Section 1-65(2) provides that Illinois law governs the "liability of a member as member and a manager as manager for the debts, obligations, or other liabilities of a limited liability company." This might apply, for example, to a member or manager who continues to operate the business of a dissolved company.
- The remaining parts of this section contain parallel provisions with regard to a series and to the obligation of one series for the debts of another.

SIGNING OF DOCUMENTS

- Section 5-45 contains simplified rules for the signing of documents on behalf of the LLC:
    - The initial articles of organization must be signed by the organizer or organizers.
    - A "document filed on behalf of a dissolved limited liability company that has no members must be signed by the person winding up the company's activities under Section 35-4."
    - "Any other document must be signed by a person authorized by the limited liability company to sign it." This might be a manager, a member or a person duly appointed by them. The authority to sign documents should be addressed in the operating agreement.
    - The words "executed in ink" are replaced by "signed".

REPORTING OF NAMES AND ADDRESSES OF MEMBERS

- As previously covered, Section 5-5(a) now requires that the names and business addresses of the managers and any member having managerial authority be included in the articles of organization. Previously, the names and business addresses of all initial members of a member-managed company had to be included.
- A parallel change is made to Section 50-1(a)(4) with respect to the information to be included in annual reports and in Section 37-40(d) with respect to filings on behalf of series.

FEES

- Changed filing fee for a statement of termination (formerly, articles of dissolution): $25 (from $100).
- New filing fees:
  - Articles of domestication: $100.
  - Statement of authority or amendment or cancellation thereof: $50.
  - Statement of denial or amendment or cancellation thereof: $10.
- These provisions are located in Section 50-10.

CONSTRUCTION AND APPLICATION

- Two important additions are made to Section 55-1.
- New Subsection 55-1(b) provides: "Subject to subsection (b) of Section 15-5 (which lists things that may not be changed in the operating agreement), it is the policy of this Act to give maximum effect to the principles of freedom of contract and to the enforceability of operating agreements." By way of background, corporations are creatures of statute and the courts have been slow to recognize and enforce agreements among shareholders. LLCs, on the other hand, are primarily creatures of contract and the courts should not be reluctant to enforce them by reason of their similarity to corporations. This policy is meant to give courts a statutory basis for enforcing operating contracts as written, subject only to the constraints of Section 5-15(b) (which expressly includes the obligation of good faith and fair dealing) and general contract principles.
- New Subsection 55-1(c) provides that rules "that statutes in derogation of the common law are to be strictly construed shall have no application to this Act."
- New Subsection 55-1(d) contains standard contractual language covering the equivalence of singular and plural, the use of a particular gender and captions.

EFFECTIVE DATE

- The effective date of the 2017Amendments is July 1, 2017.
- Counsel should take this opportunity to review all operating agreements and company structures to see how they mesh and to examine whether the agreements should be amended to take into any of the 2017 Amendments into account.

<u>QUESTIONS</u>

AGENCY CONSIDERATIONS in LLCS

Prior to the new amendments to the Illinois LLC Act,[1] the articles of organization required that the LLC be designated either as a member-managed LLC or a manager-managed LLC. Consequently, section 13-5 provided as follows:

> § 13-5. Agency of members and managers.
>
> (a) Subject to subsections (b) and (c):
>
> (1) Each member is an agent of the limited liability company for the purpose of its business, and an act of a member, including the signing of an instrument in the company's name, for apparently carrying on, in the ordinary course, the company's business or business of the kind carried on by the company binds the company, unless the member had no authority to act for the company in the particular matter and the person with whom the member was dealing knew or had notice that the member lacked authority.
>
> (2) An act of a member that is not apparently for carrying on, in the ordinary course, the company's business or business of the kind carried on by the company binds the company only if the act was authorized by the other members.

Because, in a member-managed LLC, the LLC Act provides that each member is an agent of the LLC, essentially the balance of the statute above was providing a summary perspective on the implied and apparent authority that a member has. If the member was authorized by the other members, then such member can bind the company whether or not the action taken by the member was in the ordinary course of business, since the action was authorized by the LLC and the member has real authority.

However, if the member was not authorized but the action taken was in the ordinary course of business, the member would have apparent authority. While implied authority looks through the eyes of the principal to determine what authority is given to the agent, implied authority views the situation from the eyes of the third-party, and the principal will be bound if the principal was responsible for the appearances upon which the third-party reasonably relied. If the action taken by the member was in the ordinary course of business, the third-party would be reasonable in believing that the action was authorized. On the other hand, if the third-party knew that the member in question lacked authority, the third-party could not reasonably rely on any purported appearances for which the principal was responsible.

Subsection (b) of section 13-5 created the same schema with respect to a manager in a manager-managed LLC. In a manager-managed LLC, members generally do not have agency powers, but such powers are delegated to the managers. This section provides:

> (b) Subject to subsection (c), in a manager-managed company:
>
> (1) A member is not an agent of the company for the purpose of its business solely by reason of being a member. Each manager is an agent of the company for the purpose of its business, and an act of a manager, including the signing of an instrument in the

[1] P.A. 99-637, 2016 Ill. Legis. Serv. P.A. 99-637 (H.B. 4361)(West).

company's name, for apparently carrying on, in the ordinary course, the company's business or business of the kind carried on by the company binds the company, unless the manager had no authority to act for the company in the particular matter and the person with whom the manager was dealing knew or had notice that the manager lacked authority.

(2) An act of a manager which is not apparently for carrying on, in the ordinary course, the company's business or business of the kind carried on by the company binds the company only if the act was authorized under Section 15-1.

While the express provisions of the statute purport to exclude members from agency powers, it would be possible for the managers or the members to allow a particular member to exercise management responsibilities. In such a case the member could not have apparent authority but could have express or implied authority. See, by analogy, §15-3 (g) (3) of the Act as presently in place.

The Act as presently constituted also has a simple provision for the authority to transfer real estate:

(c) Unless the articles of organization limit their authority, any member of a member-managed company or manager of a manager-managed company may sign and deliver any instrument transferring or affecting the company's interest in real property. The instrument is conclusive in favor of a person who gives value without knowledge of the lack of the authority of the person signing and delivering the instrument.

Some practitioners have been uncomfortable with the present form of section 13-5. I have not been able to understand that concern because it seemed to me that such provisions were basically declarative of the common law of agency. If you did have an "authority" issue, you needed only to determine whether the LLC was member-managed or manager-managed and whether the action taken was in the ordinary course.

The Act as amended will simply provide as follows:

§ 13-5. No agency power of a member as member.

(a) A member is not an agent of a limited liability company solely by reason of being a member.

(b) Nothing herein shall be deemed to limit the effect of law other than this Act, including the law of agency.

(c) A person's status as a member does not prevent or restrict law other than this Act from imposing liability on a limited liability company because of the person's conduct.

Thus, being a member by itself does not give the person agency powers. To glean who has management powers and by implication who has agency powers, it is necessary to consult the operating agreement. The operating agreement could provide that members qua members have management powers, or the persons designated in the operating agreement as managers have management powers, or some hybrid. In my opinion, we have now gained flexibility at the expense of certainty. It would appear that the net effect of the new provision is simply to leave us where we were before, but without the benefit of being able to assert a statutory proposition to support the apparent authority of a member. Since we are changing the legislative language, my concern is that a court may read into the change more than we intended with untoward consequences.

By way of example, section 10-10 initially provided that members could have personal liability for their actions analogous to that of shareholders in a corporation and, similarly, managers could have personal liability in situations analogous to that in which a director in a corporation could have liability. One of the reasons for such provision initially was to preserve the law with respect to piercing the entity veil. However, in the 90s, some practitioners thought that you could not pierce the veil of an LLC, or that it was undesirable to do so, and this was basically the motivation for deleting such provisions.

However, the Illinois appellate court, in Puleo v. Topel, 856 N.E. 2d1152 (2006), interpreted the legislative change as eliminating all liability for a member in an LLC, even for personal actions taken. This case and its progeny are discussed below.

So let's leave the *Puleo* problem, which deals with when is a member liable, and address the issue of when is the LLC liable. As indicated above, the LLC will be liable – under general agency principles – when a member or manager, as the case may be, has implied or apparent authority or when the LLC ratifies actions of a member or manager in a situation where the member or manager did not have authority in the first place. And, as stated above, I do not think that the situation will be any different whether it is considered before or after the new language.

What we are talking about in this context are transactions between the LLC and a third party. Either the third party is attempting to hold the LLC liable for a transaction entered into on behalf of the LLC by a member or manager (3d party v. LLC) or the LLC is seeking to take advantage of a transaction that was negotiated on its behalf by a member or manager (LLC v. 3d party). Generally, these are contractual type issues.

The next section, section 13-10, which is unchanged, would seem to address the first issue (3d party v. LLC):

> § 13-10. Limited liability company liable for member or manager's actionable conduct. A limited liability company is liable for loss or injury caused to a person, or for a penalty incurred, as a result of a wrongful act or omission, or other actionable conduct, of a member or manager acting in the ordinary course of business of the company or with authority of the company.

However, this provision, historically, came out of the old partnership provisions and was aimed at tortious or wrongful conduct on behalf of the agent. Essentially, this is a respondeat superior type provision. However, in this area, the member or manager (the agent or servant) is primarily liable and the LLC (the principal) is secondarily liable.

This brings us back to the *Puleo* problem again.[2] *Puleo* rejected the idea that a member or manager could be liable to creditors for liabilities incurred after the LLC was administratively dissolved. In so doing, the court failed to understand the nature of a limited liability company or the history and purpose of the statutory provisions in the Illinois Act.

Puleo dealt with a limited liability company that was administratively dissolved for failure to file its annual report (and very likely failure to pay the annual fee as well) on May 30, 2002. The alleged sole member, Topel, continue to operate the business until August 30, 2002, when he informed the employees and independent contractors that operations were being terminated, and thereafter failed to pay plaintiffs for the work they had performed in the interim period. The case is particularly striking because the defendant did not oppose plaintiff's motion for summary judgment. Apparently, on its own motion, the trial court denied the motion for summary judgment and entered the final order dismissing plaintiff's claims against Topel, predicated upon the trial court's reading of ILLCA. Moreover, Topel did not file a brief on appeal.

The appellate court looked to sections 10-10 of the Illinois Act, and 35-7, in order to justify its conclusion that the member was not personally liable for liabilities incurred subsequent to the dissolution of the company. The court first looked to paragraph (a) of section 10-10 which provides that the obligations of a limited liability company "are solely the debts, obligations, and liabilities of the company." But the LLC was no longer in existence so the liabilities arising after dissolution cannot be the liabilities of the LLC.

Moreover, section 10-10 (a) provides that a member or manager is not liable "solely" by acting as a member or manager. If an LLC is dissolved, its existence terminates except with respect to necessary winding up activity. When a sole member continues the business that the LLC had conducted, the member is in effect operating as a sole proprietorship, and not as a member in an LLC.

The court then looked to paragraph (d) which provided that a member would be liable if either a provision to that effect is contained in the articles of organization or if a member so consents in writing. What the court failed to appreciate is that the existence of provisions such as section 10-10 (d) historically was to enable an LLC to qualify for taxation as a partnership prior to the adoption of the check-the-box IRS regulations. Prior to these regulations, an LLC, in order to be taxed as a partnership and not as a corporation, needed to negate in its articles of organization two of the following four corporate characteristics: limited liability, centralized management, free transfer ability of interests, and continuity of existence.

Thus, this provision was not a legislative attempt to protect members from liability. It was part of a process of overhauling the original Illinois LLC Act, which was a so-called "second generation" statute, and convert it into a "third generation" or contractarian statute. While the default rule for LLC's is that members have limited liability, section 10-10 (d) provides the flexibility to override the general statutory default rule by a provision in the articles of organization, if the members so agree.

[2] This discussion, and other parts of this presentation, are extracted from Charles W Murdock, Illinois Practice Series – Business Organizations (West 2010, suppl. 2016).

The court sought to support its decision also by referencing section 35-7 of the Act which provides that a member or manager, who is aware of the dissolution and yet engages in activity that is not appropriate for winding up the business of the LLC, is liable to the **company** for any damage caused to the company. Since this provision referenced a member's liability to the company, but not to a third-party, according to the court this "silence speaks volumes when viewed in conjunction with the legislature's of amendment of the former version of section 10-10."

Again, the court misperceived the purpose of section 35-7. Once an LLC is dissolved, it is required to wind-up its business. The process of winding up requires the entity to close out its existing obligations and not to incur any new obligations. When the business is dissolved, the primary purpose of the existing assets of the business is to pay off creditors and then for any balance to be distributed to the members.

If a business continues to operate after dissolution, it may incur additional liabilities which could jeopardize not only payments to creditors, but also distributions to the members. Thus, if a member or manager continues to operates after dissolution and incurs additional liabilities, such a member or manager is liable to the LLC because such actions may jeopardize, not just the rights of third-party creditors, but also the rights of other members whose distribution may thereby be reduced or eliminated. Thus, the liability runs to the LLC so that the LLC may use the proceeds of recovery from the wrongful member or manager for the benefit of either creditors or members, depending upon the economics (the respective amounts of the creditor interests and the member interests) of the particular LLC. The purpose of the statute is clearly not to insulate a member who continues operations after dissolution from the claims of the creditors he has thereby disadvantaged.

The mischief caused by the poorly reasoned decision in *Puleo* arose again in Carollo v. Irwin, 959 N.E.2d 77 (Ill. App. 2011), the primary issue of which was whether a contract entered into by an individual on behalf of an LLC to be formed constituted a sale under a settlement agreement entered into by the parties in *Carollo.* A determination of the liability of a "promoter" was unnecessary, since the Court first held that a contract of sale was not the same thing as a sale and, thus, did not relieve defendant of liability for the settlement agreement he executed with plaintiff, which provided for a $30,000 payment if certain property was not sold before year-end. Nevertheless, the court also determined that a sale had not occurred because the "to be formed LLC" never came into existence and the promoter was not liable under the *Puleo* holding.

The faulty reasoning of the *Puleo* decision again misled an Illinois court in *Dass v. Yale*, 3 N.E.3d 858 (2013). In *Dass*, plaintiffs had purchased a garden condominium unit from Wolcott LLC (of which defendant Yale was the manager), Thereafter, plaintiffs experienced extensive flooding, which was caused by water entering the unit at the toilets and drains. This in turn was caused by a defective sewer system. The property report, which had been given to plaintiffs when they purchased, indicated that the sewerage system had been inspected and repaired and that there was all new plumbing. This was in fact not the case.

The LLC was declared bankrupt and plaintiffs later joined Yale in the lawsuit. His motion to dismiss was granted on the basis of the *Puleo* decision, which had held that a member or manager of an LLC cannot be personally liable because section 10-10 provided that a "member or manager is not personally liable for a debt, obligation, or liability of the company ***solely*** by reason of being or acting as a member or manager." Once again, an Illinois court failed to recognize the significance of the word "solely."

The court looked at the section 303 of the Uniform Limited Liability Company Act (1996) (the Uniform Act) which contains substantively the same language as section 10-10. However, the Uniform Act includes a comment to section 303 which states that a member or manager who commits a tort or fraud could be held personally liable if that person were acting in an individual capacity. The court also stated that, while some states have adopted the comment to section 303, Illinois has not. Therefore, the court was not willing to follow rulings from those states, like South Carolina in 16 Jade Street LLC v. R. Design Construction Co., LLC, 728 S.E.2d 448 (S.C. 2012), that imposed personal liability.

The *Dass,* court, like *Puleo*, looked at the history of the Illinois LLC Act itself and found that the 1998 amendment eliminated the provision that explicitly provided for personal liability for members similar to that of shareholders. Therefore, it also concluded that the intent of the legislature must have been to shield a manager or member of an LLC from personal liability. Lastly, the court rejected the argument that *Puleo* precedent does not apply because tort and fraud liability should be treated differently. Instead, the court held that "[w]e see no reason why the reasoning of *Puleo* and *Carollo*, which focused on the language of the LLC Act and its amendment, would not apply to a liability arising in tort, as in the case at bar, when such a scenario is expressly contemplated by the language of section 10-10". *Dass v. Yale*, 2013 IL App (1st) 122520, ¶ 44, 378 Ill. Dec. 293, 303, 3 N.E.3d 858, 868.

Most recently, the appellate court again followed *Puleo* in *Daniel v. Ripoli*, 2016 IL App (1st) 122607-U, ¶ 114, in which the plaintiff-estate of Daniel tried to get around the holding in *Puleo v. Topel* by arguing that the manager-defendants should be personally liable since the LLC continued to treat certain aspects of the business as a partnership, and "failed" to properly convert to LLC. However, the court rejected this argument and said that there was effective conversion and "the fact that the LLC members continued to treat aspects of the business as a partnership (for instance, filing K-1 partnership tax return statements) does not change the legal status of the business as an LLC". Therefore, the court found that the defendants had no individual liability.

A federal court, in *Aqua Thick, Inc. v. Wild Flavors, Inc.*, No. 08 C 6278, 2009 WL 4544696 (N.D.Ill. Dec. 1, 2009), also followed *Puleo* and held that a member cannot be sued individually for an LLC's torts. The federal court also relied in part on the provision in the LLCA that states that a "member or manager is not personally liable for a debt, obligation, or liability of the company *solely* by reason of being or acting as a member or manager." [Emphasis added.] 805 ILCS 180/10-10(a).

Perhaps the federal court decision can be justified on the basis that it was before the court on a motion to dismiss, and the third-party plaintiff may not have adequately pleaded facts that established that the managing member *personally* had participated in the tort that the LLC had allegedly committed. It is important to note that the statute provides that a person is not liable *solely* by reason of being a member or acting as a manager. This does not mean that such a person is not liable when he or she does an act which itself constitutes a tort. While it is true, as the federal court observed, that a member cannot be sued for the LLC's torts, this does not mean that a member cannot be sued for the member's own wrongful actions.

Because of the misinterpretation of the elimination of the original section 10-10(b) by the Illinois courts, the best way to remedy this situation is to clarify the intent of the Legislature by amending the statute in a manner similar to the following:

> Section 10-10(b) Nothing in this Act shall be deemed to limit the effect of law other than this Act with respect to imposing liability upon a member because of the member's personal conduct.

Such legislation is presently under consideration.

The only case cited in the West system under section 13-10 is In Re Securities Investor Protection Corp. v. R. D. Kushnir & Cole, 274 B.R. 768 (2002). In this case, the SIPC sought to hold an accounting firm, organized as an LLC, and the individual accountants liable for failing to uncover in an audit the depredations of an employee of a brokerage firm. Citing section 13-10, the court concluded that the accounting firm "was and is liable for acts or omissions of the individual Defendants in the course of their audit work. The court also held with respect to individual accountants that it was conceivable "that SIPC could plead and show that they are individually responsible for breaching the contract with RDK and that they should be held personally liable." The court further determined that the individual defendants' "carelessness or negligence in ascertaining the truth of their statements is enough for a cause of action for negligent misrepresentation."

After *Aqua Thick*, another federal court, in *Braucher v. Swagat Group, L.L.C.*, 702 F.Supp.2d 1032, 1047 (C.D.Ill. 2010), also recognized that members are not liable for the tortious acts of an LLC but, with respect to a member who managed the LLC's hotel and swimming pool, such a member "may or may not have some personal liability for his own actions." The plaintiffs had contracted Legionnaires' disease after swimming in the hotel's swimming pool. Deposition testimony that was considered by the court upon a motion for summary judgment indicated that the pool was not properly disinfected and that treatment logs may have been falsified. Upon trial, the court's opinion suggests that the managing member could be found liable if he was complicit in failing to properly chlorinate the pool or in falsifying the treatment logs.

Thus, courts that are not swayed by *Puleo* have recognized that members in an LLC can be personally liable for their own actions.

Now that the Act clearly invites practitioners and courts to examine the law of agency in connection with LLCs, it is important to recognize that there are a host of other issues that can arise out of agency considerations in an LLC. For example, an LLC can be adversely affected by a member or manager who acts without authority. In such a case, a member or manager can be liable to the LLC itself for exceeding his or her authority. An agent is duty bound to follow the instructions of the principal and owes the principal a duty of obedience. See Lexington Insurance Company v. Horace Mann Insurance Company, 186 F. Supp. 3d 920 (N.D. Ill.). An agent who fails to follow the directions of the principal can thus be liable to the principal for any loss the principal suffers from the failure of the agent to obey instructions.

An LLC can also be an agent itself and thus would have a duty of obedience and, with respect to third parties, would implicitly warrant that it has the authority it purports to exercise. If it exceeds its authority and the third-party is unsuccessful against the principal, the LLC could be liable to the third-party based on a breach of its warranty of authority.

If a member or manager incurs obligations or provides funds on behalf of the LLC, general agency principles would most likely require the LLC to indemnify the member or manager. However, here, we do not need to rely solely upon general agency law since section 15-7 explicitly provides for such indemnification.

Generally, when an agent acts for another, the principal for whom the agent is acting is bound, and the agent is not. In *Storm & Associates, Ltd. v. Cuculich,* 298 Ill.App.3d 1040, 700 N.E.2d 202, 211, 233 Ill.Dec. 101 (1st Dist. 1998), the court stated:

> It has been long settled in Illinois that, when an agent entering into a contract with another discloses both his agency status and the name of his principal or when the party dealing with the agent knows that the agent is acting for his principal in making a contract, the agent is not liable on the contract unless he agrees to become personally liable.

However, as stated above, it is possible for an agent to be liable to his or her principal if the agent exceeds the authority that the principal has given him or her, or the agent can be liable to a third party if the agent misrepresents his or her authority to the third party. What seems to be a more persistent problem, in both the corporate area and the LLC area, is the failure of the agent to identify either his or her principal or the fact that he or she is acting as an agent. In such a case, the agent is personally liable on the contract. The Illinois appellate court in *Mawer-Gulden-Annis, Inc. v. Brazilian & Colombian Coffee Co.,* 49 Ill.App.2d 400, 199 N.E.2d 222, 225 (1st Dist. 1964), upheld the liability of an agent that did not disclose that it was acting for a principal, quoted from an earlier Supreme Court case, and stated:

> It is a settled rule in verbal contracts, if the agent does not disclose his agency and name his principal, he binds himself and becomes subject to all liabilities, express and implied, created by the contract and transaction, in the same manner as if he were the principal in interest. . . . And the fact that the agent is known to be a commission merchant, auctioneer, or other professional agent, makes no difference. **[**Citations omitted.**]** Quoting *Wheeler v. Reed,* 36 Ill. 81, 90 (1864).

The *Mawer-Gulden-Annis* court added that "[t]o avoid personal liability, disclosure of the principal must be made at the time of contracting, otherwise either the agent or the subsequently disclosed principal may be held." 199 N.E.2d at 225.

Undisclosed or partially disclosed principal problems can be expected to be even more prevalent in LLCs than in corporations because of the greater informality involved in LLCs and the fact that, because of the ease of organization, many LLCs are organized by nonlawyers who are not sensitive to undisclosed principal problems.

One of the earliest cases to deal with the undisclosed principal issue with an LLC is *Water, Waste & Land, Inc. v. Lanham*, 955 P.2d 997 (Colo. 1998) (en banc). Lanham and Clark were the managers and members of Preferred Income Investors, L.L.C. Clark contacted the plaintiff to do some engineering work for a fast-food restaurant but did not clarify for whom he was acting. According to the court:

> In the course of preliminary discussions, Clark gave his business card to representatives of Westec. The business card included Lanham's address, which was also the address listed as the Company's principal office and place of business in its articles of organization filed with the secretary of state. While the Company's name was not on the business card, the letters "P.I.I." appeared above the address on the card. However, there was no indication as to what the acronym meant or that P.I.I. was a limited liability company. 955 P.2d at 999.

The court also noted:

> Westec directed all correspondence relating to the restaurant project to Lanham, including a written contract and bills. Both the form of contract and correspondence between the two parties were in Lanham's name and did not refer to the Company. Lanham never signed Westec's proposed written contract, and the parties do not dispute that the oral agreement is the only binding contract in this case. 955 P.2d at 999 n.2.

The Colorado statute contained the following provision:

> The fact that the articles of organization are on file in the office of the secretary of state is notice that the limited liability company is a limited liability company and is notice of all other facts set forth therein which are required to be set forth in the articles of organization. 955 P.2d at 1002, quoting Colo.Rev.Stat. §7-80-208.

This provision is similar to §5-70 of the Limited Liability Company Act, and the defendant argued that this statute, coupled with the filing of the articles of incorporation, gave the plaintiff constructive notice that Lanham was acting for the LLC.

The court rejected this argument on the basis that it exaggerated the plain meaning of the statute and that such an interpretation would be invitation to fraud. The court held that the statute

> places third parties on constructive notice that a fully identified company — that is, identified by a name such as "Preferred Income Investors, LLC," or the like — is a limited liability company provided that its articles of organization have been filed with the secretary of state. Section 7-80-208 is of little force, however, in determining whether a limited liability company's agent is personally liable on the theory that the agent has failed to disclose the identity of the company. 955 P.2d at 1004.

In determining liability, the court found that Westec understood that Clark was Lanham's agent and that Clark was therefore not liable. However, the court held Lanham liable on the basis "of the partially disclosed principal doctrine" (*i.e.*, "a principal whose existence — but not identity — is known to the other party"). 955 P.2d at 1002. The court concluded that, "[i]n light of the partially disclosed principal doctrine, the county court's determination that Clark and Lanham failed to disclose the existence as well as the identity of the limited liability company they represented is dispositive under the common law of agency." *Id.*

Members of LLCs have frequently been held liable because of their ineptness in executing documents that they intended would bind the LLC rather than themselves. For example, in *Warren Supply Co. v. Lyle's Plumbing, L.L.C.,* 74 S.W.3d 816 (Mo.App. 2002), the plaintiff requested that the LLC sign a credit application. The one-page document contained a credit application at the top and a personal guarantee at the bottom. Clegg, a 51-percent member, signed the document at the bottom and identified himself as a member. When he was later sued personally on the guarantee, he claimed the document was ambiguous because the only signature on the document was his as a member. He argued that he had intended to sign the credit application, not the personal guarantee, on behalf of the LLC. However, since the LLC was not identified in the document, the court treated the situation as one involving a partially disclosed principal and held him personally liable.

In *Wirthman-Tag Construction Co. v. Hotard*, 804 So.2d 856, 858 (La.App. 2001), a construction contract was executed by the builder as follows: “Wirthman-TAG Const. By: Thomas A. Gennusa, III and Ronald Wirth, Jr.” The Hotards claimed that there was no designation that the two individuals were acting for an LLC and that, accordingly, the individuals should be personally liable. In reversing the judgment of the trial court, the appellate court determined that the Hotards were entitled to their day in court to determine whether the intent of the parties was that the individuals would be personally liable. In another case involving real estate, *Baumstein v. Myklebust*, 247 Wis.2d 992, 635 N.W.2d 28 (Wis.App. 2001) (text available in Westlaw), the defendant claimed that he should not have been personally liable for the return of earnest money, because he was a member of an LLC. Not only was there confusion on behalf of the defendant as to which LLC he was representing, but he also signed only his own name as “Seller” on the one document that was executed. Failure to have the correct name of the LLC on a lease, executed purportedly on behalf of an LLC, exposed members to liability in *Harmon Building Associates v. Weinmann*, 54 Va.Cir. 130 (2000).

Let’s return to the issue of who has, or who does not have, authority to act for the LLC. As stated earlier, the Act as presently constituted has a simple provision relating to the authority to transfer real estate:

> (c) Unless the articles of organization limit their authority, any member of a member-managed company or manager of a manager-managed company may sign and deliver any instrument transferring or affecting the company’s interest in real property. The instrument is conclusive in favor of a person who gives value without knowledge of the lack of the authority of the person signing and delivering the instrument.

However, the Act as amended has much more detailed provisions dealing with granting or limiting the authority of a member, or manager, or any other person:

> § 13-15. Statement of authority.
>
> (a) A limited liability company may deliver to the Secretary of State for filing a statement of authority. The statement:
>
> (1) must include the name of the company and the address of its principal place of business; and
>
> (2) may state the authority, or limitations on the authority, of any member or manager of the company or any other person to:
>
> (A) execute an instrument transferring real property held in the name of the company; or
>
> (B) enter into other transactions on behalf of, or otherwise act for or bind, the

company.

(b) To amend or cancel a statement of authority, a limited liability company must deliver to the Secretary of State for filing a statement of amendment or cancellation. The statement must include:

(1) the name of the limited liability company and the address of its principal place of business;

(2) the date the statement of authority being amended or cancelled became effective; and

(3) the contents of the amendment or a declaration that the statement of authority is canceled.

(c) Except as otherwise provided in subsections (e) and (f), a limitation on the authority of a member or manager of the limited liability company contained in a statement of authority is not by itself evidence of knowledge or notice of the limitation by any person.

(d) A grant of authority not pertaining to transfers of real property and contained in a statement of authority is conclusive in favor of a person that is not a member and that gives value in reliance on the grant, except to the extent that when the person gives value, the person has knowledge to the contrary.

(e) A certified copy of a statement of authority that grants authority to transfer real property held in the name of the limited liability company and that is recorded in the office for recording transfers of the real property is conclusive in favor of a person that is not a member and that gives value in reliance on the grant without knowledge to the contrary.

(f) If a certified copy of a statement of authority containing a limitation on the authority to transfer real property held in the name of a limited liability company is recorded in the office for recording transfers of that real property, all persons that are not members are deemed to know of the limitation.

(g) Unless previously cancelled by a statement of cancellation, a statement of authority expires as of the date, if any, specified in the statement of authority.

(h) If the articles of organization state the authority or limitations on the authority of any person on behalf of a company, the authority stated or limited shall not bind any person who is not a member or manager until that person receives actual notice in a record from the company that agency authority is stated or limited in the articles. If the authority stated or limited in the articles of organization conflicts with authority stated or limited in a statement of authority filed with the Secretary of State under this Section on behalf of the company, the statement of authority is the effective statement and a person who is not a member or manager may rely upon the terms of the filed statement of authority notwithstanding conflicting terms in the articles of organization.

Let’s parse this out. Subsections (a) and (b) simply set forth the mechanics to create a statement of authority or to amend or cancel it. Subsection (g) provides when it expires, and subsection (h) in effect provides the articles of organization do not provide constructive notice to a third party; rather actual notice is necessary. Moreover, it provides that the statement of authority trumps the articles of organization with respect to any grant or limitation of authority.

The meat of the provision is in subsections (c) through (f). Subsections (e) and (f) deal with real estate, whereas subsection (c) [in effect] and subsection (d) deal with non-real estate type transactions. Basically, subsection (c) provides that a limitation on authority in a statement of authority does not provide constructive notice. In other words, knowledge of a limitation of authority in a statement of authority is not presumed and therefore would not kill apparent authority asserted by a third party. However, with respect to real estate, subparagraph (f) would provide constructive knowledge if the statement of authority is recorded where the real estate is located.

Thus, subsections (c) and (f) deal with limitations on authority. A limitation upon authority provides constructive notice, thereby defeating a claim of apparent authority, only with respect to real estate and only if it is recorded.

Subparagraphs (d) and (e) deal with a grant of authority and whether a third-party can rely upon the statement of authority to sustain a claim of apparent authority, even if the person or persons named in the statement of authority are no longer authorized to act. Subsection (d) deals with the non-real estate type situations and provides that a person who gives value without actual knowledge to the contrary can rely upon a statement of authority. Subsection (e) deals with the real estate type situation and provides that a third-party can rely upon the statement of authority only if it is recorded and the person has no contrary knowledge.

The Act as amended also has a new provision whereby a person who is named in a statement of authority can deny the grant of authority:

> § 13-20. Statement of denial. A person named in a filed statement of authority granting that person authority may deliver to the Secretary of State for filing a statement of denial that:
>
> (1) provides the name of the limited liability company and the caption of the statement of authority to which the statement of denial pertains; and
>
> (2) denies the grant of authority.
>
> An effective statement of denial operates as a restrictive amendment under subsection (b) of Section 13-15 and, if a certified copy thereof is recorded in the office for recording transfers of real property in which a prior statement of authority has been recorded as provided in subsection (e) of Section 13-15, the statement of denial shall be deemed a limitation on the statement of authority for purposes of subsection (f) of Section 13-15.

Question might be asked as to why a person would want to deny having authority; it would seem that they only need not to exercise it. However, in analogous provision is in the Business Corporation Act. BCA §8.65 (b) provides a director who was present at a meeting is conclusively presumed to have assented to the actions taken at that meeting,unless his or her dissent is entered in the minutes or the director files a written dissent with the secretary, either before adjournment or by registered or certified mail immediately after the meeting. Consider, for example, an action taken at a meeting which the director believes would violate the duty of care and accordingly opposes it. If the director did not formally dissent, the director might be liable with the other directors. By following the foregoing procedure, the director arguably can foreclose liability.

It is possible to envision a similar scenario in an LLC when certain members or managers have authority to take action, which one of them believes is ill advised. By filing a statement of denial, arguably the member or manager who was named as having authority can escape liability for any untoward consequences that come from the exercise by others of that authority.

RIGHTS AND OBLIGATIONS OF TRANSFEREES, DISSOCIATED MEMBERS AND CREDITORS

Let us start with some general principles (per CWM) with which you may or may not agree: (a) being a member is wonderful; (b) being a transferee is a disaster; (c) since a creditor's remedy is limited to a charging order, and since a charging order only entitles a creditor to whatever distributions are made (which may be none), being a creditor is a disaster; and (d) since a purchaser at a judicial sale is a transferee, being a purchaser of a foreclosed distributional interest is a disaster.

The second principle – or better, perspective – is that, as you can see from the title, there are 3 types of non-member interests that we need to examine: (i) transferees; (ii) dissociated members; and (iii) creditors. But dissociated members are deemed to be transferees, which may thus cause some confusion. And creditors are essentially transferees and become such if they purchase at a judicial sale.

So why is being a transferee a disaster? To get some perspective, let us contrast the status of a shareholder in a corporation with a member in an LLC. Now one of the things we will be discussing today is the elimination of the right of a member to be bought out upon dissociation. The rationale for this change was that, in a corporation, a shareholder has no statutory right to be bought out, so why should a member, in an LLC, have such right?

To put this into perspective, consider the situation of the spouse of an investor who dies.

In a corporation, the spouse can inherit the stock and become a shareholder. As a shareholder, assuming she has sufficient shares, she may well be able to elect herself, under cumulative voting, to the Board of Directors and thus will have some management powers, albeit in a shared context with other directors. As a shareholder, she has a right to vote in elections of directors and other significant matters, such as mergers or sales of assets. Also, as a shareholder, she has a right to examine the corporation's books and records of account, so long as it is for a proper purpose. And case law has defined proper purpose fairly broadly. Should she be able to elect herself to the Board of Directors, she would have complete access to the books and records of the company pursuant to her directorial responsibilities. If we consider removal of a director in a corporation as analogous to expulsion of a member in an LLC, she cannot be removed as a director if the votes cast against her removal would have been sufficient to elect her in the first place. Thus, in effect, if she has enough votes to get on the board, she cannot be removed from the board.

Now consider the situation of a spouse of a member who dies. When he or she dies, the deceased's spouse becomes a transferee, as does any successor in interest. Thus, the wife is a transferee. As a transferee, she has no management power whatsoever. Moreover, from an information standpoint, a transferee is not entitled to "access to information concerning the company's transactions," and the informational rights are those provided in section 1-40. This section provides very bare-bones information: information about the members and their contributions, copies of the articles of organization and operating agreement, and copies of tax returns and financial statements for the three most recent years.

Since there is no access to operating information, the transferee has no access to information about whether members have increased their compensation, hired relatives to spread the wealth within the family, or engaged in self-dealing transactions with other businesses that are owned and operated by them.

Contrariwise, in a corporation, there are very expensive informational rights under BCA 7.75. *Sunlitz Holding Co., W.L.L. v. Trading Block Holding, Inc.*,[1] involved a very extensive demand to inspect the books and records of the defendant corporation, as summarized below:[2]

1. Articles of incorporation, by-laws, shareholder agreements and amendments thereto	2. Agendas and minutes from board of directors' meetings occurring from Jan. 1, 2011 to the present
3. Board of directors' resolutions from Jan. 1, 2011 to present	4. Share certificates
5. Current and original capitalization tables with explanations for any differences	6. Any contracts between Trading Block and its officers or directors
7. A range of financial statements from Jan. 1, 2011 to present, including balance sheets and income and cash flow statements	8. The general ledger and Quickbooks files
9. Accounts payable and receivable from Jan. 1, 2011 to present	10. Federal and state income tax returns from Jan. 1, 2011 to present
11. Marketing and private placement memoranda used to raise capital	12. All reports filed with regulatory agencies
13. Any correspondence with the FIRA, SEC or CBOE from Jan. 1, 2011 to present	14. All offer letters sent to brokers from Jan. 1, 2011 to present
15. All documents relating to a stock option plan adopted by Trading Block in 2012	16. All documents related to Trading Block's offer to exchange Series A Preferred Stock for Secured Promissory Notes At $1.10 per share

The purpose for plaintiffs' request for the aforesaid information was that it was needed:

> [T]o understand fully and assess the financial condition of TradingBlock, [*sic*] how the company is being managed, whether the company's financial practices are appropriate, and whether there has been any self-dealing by TradingBlock's [*sic*] management and/or members of the Board of Directors that has had a negative impact on the company as a whole or shareholders, in particular. [3]

Defendants argued that plaintiffs' demand was not sufficiently particularized because they failed to identify the allegedly self-dealing by directors. The court responded that defendants' argument placed "too heavy a burden on plaintiffs" since the particularity

[1] 17 N.E.3d 715, 716 (Ill. App. Ct. 2014). This discussion, and other parts of this presentation, are extracted from Charles W Murdock, Illinois Practice Series – Business Organizations (West 2010, suppl. 2016).
[2] Id. at 717.
[3] Id. at 718 (parenthetical in original).

requirement is “a relative one, turning on the degree of knowledge that a movant in a particular case has about the documents he requests.”[4]

Defendants also contended that the breadth of plaintiffs’ inspection request demonstrates that they had no proper purpose. The court rejected this argument as well:

> The breadth of plaintiffs’ requested inspection does not compel us to find that their purpose was improper. Critically, this court has “held that once a proper purpose has been established, ‘the shareholder’s right [to inspect] extends to *all* books and records necessary to make an intelligent and searching investigation’ and ‘from which he can derive any information that will enable him to better protect his interests.’”[5]

Thus, with respect to the rights of transferees, the corporate form is far superior to the LLC form.

Let us now look at why a transferee is impotent. Consider the following two sections:

§ 30–5. Transfer of a distributional interest.

(a) A transfer of a distributional interest in whole or in part:[6]

(1) does not by itself cause dissolution and winding up of the limited liability company’s activities; and

(2) is subject to Section 30–10.

(b) A transfer of a distributional interest does not entitle the transferee to become or to exercise any rights of a member. A transfer entitles the transferee to receive, to the extent transferred, only the distributions to which the transferor would be entitled.

Comment: the foregoing section provides that a transfer of a distributional interest is not entitled the transferee to become a member and only entitles the transferee to any distributions that **might** be made in the future.

§ 30–10. Rights of a transferee.

(a) A transferee of a distributional interest may become a member of a limited liability company if and to the extent that the transferor gives the transferee the right in accordance with authority described in the operating agreement or all other members consent.

Comment: this provision shows how important it is if, for example, it is expected that a family

[4] *Id.* at 722.

[5] *Id.* at 723 (citing *Corwin v. Abbott Laboratories,* 353 Ill.App.3d 848, 850, 819 N.E.2d 1249 (2004) (quoting *Weigel,* 57 Ill.App.3d at 1027, 15 Ill.Dec. 75, 373 N.E.2d 421) (emphasis in original)); see also *Hagen,* 328 Ill.App.3d at 144, 262 Ill.Dec. 24, 764 N.E.2d 1141.

[6] Material that is added by the amendment as indicated by boldfaced highlighting, and deleted material as indicated by strikethrough.

member will come into the business, that such possibility is contemplated by the operating agreement and that there is a specific provision that a family member transferee does become a member, or else such possibility is at the sufferance of unanimous agreement by the other members

(b) A transferee who has become a member, to the extent transferred, has the rights and powers, and is subject to the restrictions and liabilities, of a member under the operating agreement of a limited liability company and this Act. A transferee who becomes a member also is liable for the transferor member's obligations to make contributions under Section 20–5 and for obligations under Section 25–35 to return unlawful distributions, but the transferee is not obligated for the transferor member's liabilities unknown to the transferee at the time the transferee becomes a member.

Comment; At least, a transferee who does not become a member is not liable to fulfil the transferor's obligation to contribute or return improper distributions.

(c) Whether or not a transferee of a distributional interest becomes a member under subsection (a) of this Section, the transferor is not released from liability to the limited liability company under the operating agreement or this Act.

(c) A transferee who does not become a member is not entitled to participate in the management or conduct of the limited liability company's business, require access to information concerning the company's transactions, or**, except as provided in subsections (c) and (d) of Section 1–40,** inspect or copy any of the company's records.

Comment: This is the key impotent-producing provision – no management rights and little access to information

(e) A transferee who does not become a member is entitled to:

(1) receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled;

(2) receive, upon dissolution and winding up of the limited liability company's business:

(A) in accordance with the transfer, the net amount otherwise distributable to the transferor; and

(B) a statement of account only from the date of the latest statement of account agreed to by all the members**.** ~~; and~~

~~(3) seek under subdivision (5) of Section 35-1 a judicial determination that it is equitable to dissolve and wind up the company's business.~~

(f) A limited liability company need not give effect to a transfer until it has notice of the transfer.

Negative Comment: so this is what you get – current distributions, if there are any, and a return of equity only if the LLC is dissolved. From an informational standpoint, you only get a statement of account from the date of the latest statement of account agreed to by all the members, which could be as late as a week ago. In other words, upon dissolution, you would not necessarily learn of any untoward activity that had occurred prior to dissolution.

Positive Comment: the deleted material may actually work to the benefit of a transferee because, under the Act in its current form, a transferee who seeks dissolution must establish that it is equitable to dissolve the company's business, a concept about which there is not much judicial definition, whereas, under the Act as amended, a transferee can obtain dissolution, or possibly an alternative remedy including a buyout, if those in control of the company have acted illegally, fraudulently, or **oppressively.** Oppression is a fairly well defined judicial concept.

Prior to the effectiveness of the new amendments, in a member-managed LLC, the LLC had the obligation to buy back the members interest upon dissociation, but that is no longer the case. See amended section 35-55 below:

§ 35–55. Effect of member's dissociation.

(a) ~~Upon a member's dissociation the company must cause the dissociated member's distributional interest to be purchased under Section 35-60. (b)~~ Upon a member's dissociation from a limited liability company:

(1) the member's right to participate in the management and conduct of the company's business terminates, except as otherwise provided in Section 35–4, and the member ceases to be a member and is treated the same as a transferee of a member;
(2) the member's fiduciary duties terminate, except as provided in subdivision (3) of this subsection **(a)** ~~(b)~~; ~~and~~

(3) the member's duty of loyalty under subdivisions (1) and (2) of subsection (b) of Section 15–3 and duty of care under subsection (c) of Section 15–3 continue only with regard to matters arising and events occurring before the member's dissociation, unless the member participates in winding up the company's business pursuant to Section 35–4**; and**~~.~~

(4) subject to Section 30–25 and Article 37, any distributional interest owned by the person immediately before dissociation in the person's capacity as a member is owned by the person solely as a transferee.

(b) A person's dissociation as a member of a limited liability company does not of itself discharge the person from any debt, obligation, or other liability to the company or the other members which the person incurred while a member.

Thus, the buyback is now gone and the impact of dissociation is to convert the member into a transferee. Consequently, the only way to get at the value of the dissociated members interest is to dissolve the LLC.

So let's take a brief look at how you can dissolve an LLC:

§ 35–1. Events causing dissolution and winding up of company's business.

(a) A limited liability company is dissolved~~,~~ and~~, unless continued pursuant to subsection (b) of Section 35–3,~~ its business must be wound up~~,~~ upon the occurrence of any of the following events:

(1) An event **or circumstance that causes the dissolution of a company by the express terms of** ~~specified in~~ the operating agreement.

(2) **The consent of all members** ~~Consent of the number or percentage of members specified in the operating agreement~~.

(3) **The passage of 180 consecutive days during which the company has no members** ~~An event that makes it unlawful for all or substantially all of the business of the company to be continued, but any cure of illegality within 90 days after notice to the company of the event is effective retroactively to the date of the event for purposes of this Section~~.

(4) On application by a member or a dissociated member, upon entry of a judicial decree that:

(A) the economic purpose of the company **has been or** is likely to be unreasonably frustrated;

(B) **the** ~~another member has engaged in~~ conduct **of all or substantially all of** ~~relating to~~ the company's **activities is unlawful** ~~business that makes it not reasonably practicable to carry on the company's business with that member~~;

(C) it is not otherwise reasonably practicable to carry on the company's business in conformity with the articles of organization and the operating agreement**.**~~;~~

Comment: here is where we contrast a dissociated member (who is a transferee) with a non-former member transferee. But how broad is subsection (a) (4)? (A) may have some applicability if the company is losing money and is likely to continue to do so in the future. A member might dissociate and sue for dissolution to stop the drain of assets. But this would be a fairly risky strategy because it would leave the other members or managers in unfettered control. (B) is highly unlikely and (C) does not seem to add much. This then leaves us with subsection (a) (5) where oppression is the likely trigger for dissolution.

(5) On application by a member or transferee of a ~~(D) the company failed to purchase the petitioner's~~ distributional interest**, upon entry of a judicial decree that** ~~as required by Section 35–60; or (E)~~ the managers or **those** members in control of the company**:**

(A) have acted, are acting, or will act in a manner that is illegal~~,~~ ~~oppressive,~~ or fraudulent**; or** ~~with respect to the petitioner.~~

(B) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant.

~~(5) On application by a transferee of a member's interest, a judicial determination that it is equitable to wind up the company's business.~~

(6) Administrative dissolution under Section 35–25.

(b) In a proceeding under subdivision (4) or (5) of subsection (a), the court may order a remedy other than dissolution including, but not limited to, a buyout of the applicant's membership interest.

Comment: thus, a transferee can achieve dissolution if the transferee can establish that the acts of those in control were oppressive or, alternatively, the interest of the transferee could be repurchased. If those in control are "appropriating" all the earnings of the LLC through salaries or other devices to funnel earnings out of the LLC in a form other than distribution, this arguably would be oppressive conduct. The problem is, how will the transferee learn of this if a transferee has no informational rights.

§ 35–3. Limited liability company continues after dissolution.

(a) Subject to subsections (b)**,** ~~and~~ (c)**, and (d)** of this Section, a limited liability company continues after dissolution only for the purpose of winding up its business.

(b)

***

(c) If there are no members, the legal representative of the last remaining member may, within one year after the occurrence of the event that caused the dissociation of the last remaining member, agree in writing to continue the limited liability company. In that event, the legal representative or its nominee or designee will be admitted to the company as a member and the company will not be dissolved or its business wound up until the occurrence of a future event of dissolution, if any.

(d) This Section does not apply in the case of a dissolution described in subdivision (4), (5), or (6) of Section 35–1.

Comment: there is some conflict between this provision which provides that, when there are no members, the legal representative of the last remaining member can in effect resuscitate the LLC within one year, whereas section 35-1 (a) (3) provides for dissolution after 180 days if there are no members.

Let us now take a look at the rights of a judgment creditor. As can be seen from section 30-20 below, there are many changes but, unless I am missing something, not much change of substance. Probably the key provisions are in subsection (a) which provides that "A charging order grants no other rights with respect to the assets or affairs of the company," and subsection (c) which provides "The purchaser at the foreclosure sale obtains only the distributional interest and does not thereby become a member, and is subject to section 30-10." Probably the intent was to foreclose the possibility of a purchaser at a foreclosure sale becoming a member as has occurred in some proceedings involving a single member LLC.

§ 30–20. Rights of creditor.

(a) **On application by a judgment creditor of a member or transferee, a court may enter a charging order against the distributional interest of the judgment debtor for the unsatisfied amount of the judgment. A charging order constitutes a lien on a judgment debtor's distributional interest and requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the judgment debtor. A charging order grants no other rights with respect to the assets or affairs of the company** ~~On application by a judgment creditor of a member of a limited liability company or of a member's transferee, a court having jurisdiction may charge the distributional interest of the judgment debtor to satisfy the judgment. The court may appoint a receiver of the share of the distributions due or to become due to the judgment debtor and make all other orders, directions, accounts, and inquiries the judgment debtor might have made or which the circumstances may require to give effect to the charging order~~.

(b) To the extent necessary to effectuate the collection of distributions pursuant to a charging order in effect under subsection (a), the court may:

> **(1) appoint a receiver of the distributions subject to the charging order, with the power to make all inquiries the judgment debtor might have made; and**
>
> **(2) make all other orders necessary to give effect to the charging order.** ~~A charging order constitutes a lien on the judgment debtor's distributional interest. The court may order a foreclosure of a lien on a distributional interest subject to the charging order at any time. A purchaser at the foreclosure sale has the rights of a transferee.~~

(c) **At any time the court may foreclose the lien and order the sale of the distributional interest. The purchaser at the foreclosure sale obtains only the distributional interest, does not thereby become a member, and is subject to Section 30–10.** ~~At any time before foreclosure, a distributional interest in a limited liability company that is charged may be redeemed:~~

> ~~(1) by the judgment debtor;~~
>
> ~~(2) with property other than the company's property, by one or more of the other members; or~~
>
> ~~(3) with the company's property, but only if permitted by the operating agreement.~~

(d) **At any time before foreclosure under subsection (c), the member or transferee whose distributional interest is subject to a charging order under subsection (a) may extinguish the charging order by satisfying the judgment and filing a certified copy of the satisfaction with the court that issued the charging order.** ~~This Act does not affect a member's right under exemption laws with respect to the member's distributional interest in a limited liability company.~~

(e) **At any time before foreclosure under subsection (c), a limited liability company or one or more members whose distributional interests are not subject to the charging order may satisfy the judgment and thereby succeed to the rights of the judgment creditor, including the charging order.** ~~This Section provides the exclusive remedy by which a judgment creditor of a member or a transferee may satisfy a judgment out of the judgment debtor's distributional interest in a limited liability company.~~

(f) This Act does not deprive any member or transferee of the benefit of any exemption laws applicable to the member's or transferee's distributional interest.

(g) This Section provides the exclusive remedy by which a person seeking to enforce a judgment against a member or transferee may, in the capacity of judgment creditor, satisfy the judgment from the judgment debtor's distributional interest. If and to the extent that other law permits a judgment creditor to obtain a lien against the distributional interest or other rights of a member or transferee of a member, the lien shall be treated as a charging order subject to all the provisions of this Section.

§ 30–25. Power of personal representative of deceased member. If a member dies, the deceased member's personal representative or other legal representative may exercise the rights of a transferee provided in subsection (e) of Section 30–10 and, for the purposes of settling the estate, the rights of a current member under Section 10–15.

Many transactional lawyers do not get involved in collection matters and thus the following excerpt[7] may help to provide a perspective on a charging order and its enforcement.

Effective January 1, 2012, the Code of Civil Procedure was amended to add a new provision by which the remedy of a charging order could be obtained, inter alia, by serving a citation to discover assets, either on the judgment debtor or against any third party who possesses property belonging to the judgment debtor. The new provision is as follows:

§ 12-112.5. Charging orders. If a statute or case requires or permits a

[7] Charles W Murdock, Illinois Practice Series – Business Organizations §5:14 (West 2010, suppl. 2016).

> judgment creditor to use the remedy of a charging order, said remedy may be brought and obtained by serving any of the various enforcement procedures set forth within this Article XII or by serving a citation pursuant to Section 2-1402. If the court does not otherwise have jurisdiction of the parties, the law relating to the type of enforcement served shall be used to determine issues ancillary to the entry of a charging order such as jurisdiction, liens, and priority of liens.

The Code presently provides with respect to the creation of a lien when a citation is served as follows:

> (m) The judgment or balance due on the judgment becomes a lien when a citation is served in accordance with subsection (a) of this Section. The lien binds nonexempt personal property, including money, choses in action, and effects of the judgment debtor as follows:
>
> > (1) When the citation is directed against the judgment debtor, upon all personal property belonging to the judgment debtor in the possession or control of the judgment debtor or which may thereafter be acquired or come due to the judgment debtor to the time of the disposition of the citation.
> >
> > (2) When the citation is directed against a third party, upon all personal property belonging to the judgment debtor in the possession or control of the third party or which thereafter may be acquired or come due the judgment debtor and comes into the possession or control of the third party to the time of the disposition of the citation.

Consequently, a charging order can be obtained by serving a citation to discover assets, which has the effect of creating a lien on any property of the judgment debtor or any third-party holding property of the judgment debtor, both on property that exists at the time of the service of the citation and also upon any after-acquired property.

Prior to this legislation, the Code of Civil Procedure had no reference to charging orders, which created confusion with respect to such matters, such as priority of liens. This confusion can be illustrated by the 2010 case of First Mid-Illinois Bank & Trust, N.A. v. Parker. There were several claimants to the judgment debtors' distributional interests in an LLC. The following timeline describes the relevant activities:

December 7, 2006: First Bank obtained a judgment against the defendants

March 29, 2007: First Bank served a citation to discover assets *on the LLC*

January 8, 2008: Mid-Illinois obtained a pre-judgment attachment order against defendants' property interests

February 25, 2008: MDB Electric and Regal Sales obtained a judgment against defendants

May 2, 2008: Mid-Illinois obtained a judgment against defendants

May 23, 2008: MDB Electric and Regal Sales obtained a charging order against defendants

June 6, 2008: Mid-Illinois obtained a charging order against defendants

MDB Electric and Regal Sales argued that, since they obtained charging orders prior to Mid-Illinois, their charging order had priority. On the other hand, Mid-Illinois argued that its charging order related back to when it obtained a pre-judgment attachment. The court agreed with Mid-Illinois.

If MDB Electric and Regal Sales had obtained a charging order by serving a citation to discover assets upon the defendants, and if Mid-Illinois had not obtained a pre-judgment attachment, they would have had priority because their lien would have attached on May 23, 2008, prior to Mid-Illinois' June 6, 2008 charging order. But, since Mid-Illinois did obtain a pre-judgment attachment, under the Mid-Illinois case, it still would have had priority. The critical issue is not how the lien attached, but rather priority which is determined by the point in time at which the lien attaches.

But, what about the citation that First Bank obtained in 2007? Unfortunately for First Bank, it served the citation to discover assets upon the LLC, which did not have any assets of the defendants, since the LLC is a legal entity separate and distinct from the members. Consequently, the LLC had no property to which the citation lien could attach. Had it served the citation to discover assets upon the defendants, it would have had priority, since its lien on defendants' property, including their distributional interests in the LLC, would have attached on March 27, 2007.

But the service of First Bank's 2007 citation would have given it a lien on any distributions to be made to the judgment debtor since, once a distribution is authorized, the member has the status of a creditor vis-à-vis the LLC, and thus the LLC has property of the member. And the citation would attach to any after-acquired property. However, the 2008 charging orders of the judgment creditors also would create a lien on the defendants' distributional interests. Which would have priority? Arguably, First Bank would have priority under the lien created by the 2007 citation, even though the other creditors' lien on the member's *distributional interest* attached prior to the lien on the *distribution*, which could not attach until there was a distribution. This is arguable and premised on the relation-back approach taken by the *First Mid-Illinois* court.

Prudence would dictate that the judgment creditor would serve a citation on both the judgment debtor and the LLC to avoid this potential conflict with respect to a distribution.

The other factor of which to be aware is that what the foregoing accomplishes is to get a lien on both any distributions and on the distributional interest. But, that still does not necessarily result in any cash or other marketable assets in the hands of the creditor. Except possibly with respect to a one-member LLC, the LLC must be dissolved in order to get at the LLC's assets.

Finally, let us take a look at the statutory provisions regarding informational rights for members and transferees:

> § 10-15. Member's right to information. [Pre-amendment]
>
> (a) A limited liability company shall provide members and their agents and attorneys access to its records, including the records required to be kept under Section 1-40, at the company's principal place of business or other reasonable locations specified in the operating agreement. The company shall provide former members and their agents and attorneys access for proper purposes to records pertaining to the period during which they were members. The right of access provides the opportunity to inspect and copy records during ordinary business hours. The company may impose a reasonable charge, limited to the costs of labor and material, for copies of records furnished.
>
> (b) A member has the right upon written demand given to the limited liability company to obtain at the company's expense a copy of any written operating agreement.

> § 10-15. Right of members and dissociated members to information. [Post-amendment]
>
> (a) A company shall furnish information when any member demands it in a record concerning the company's activities, financial condition, and other circumstances of the company's business necessary to the proper exercise of a member's rights and duties under the operating agreement or this Act or that is otherwise material to the membership interest of a member, unless the company knows that the member already knows that information.
>
> (b) The following rules apply when a member makes a demand for information under this Section:
>
> > (1) During regular business hours and at a reasonable location and time specified by the company, a member may obtain from the company, inspect, and copy information for a purpose consistent with subsection (a).
> >
> > (2) Within 10 days after receiving a demand pursuant to subsection (a):
> >
> > > (A) the company shall provide the information demanded or, in a record, a description of the information the company will provide, stating a reasonable time within which it will be provided and the place where it will be provided; and
> > >
> > > (B) if the company declines to provide any demanded information, the company shall state its reasons for declining to the member in a record.
> >
> > (c) Whenever this Act or an operating agreement provides for a member to give or withhold consent to a matter, before the consent is given or withheld, the company shall, without demand, provide the member with all information that is known to

the company that is material to the member's decision.

(d) Within 10 days after a demand made in a record received by the limited liability company, a dissociated member may have access to information to which the person was entitled while a member if the information pertains to the period during which the person was a member, and the person seeks the information in good faith for a purpose consistent with subsection (a). The company shall respond to a demand made pursuant to this subsection in the manner provided in subdivisions (A) and (B) of paragraph (2) of subsection (b).

One kind of transferee, namely, a dissociated member, does have broader access than transferees in general, such access is limited to the information relevant to the. That the dissociated member was a member. Thus, in expelled or disabled member who dissociates still would have no right to information for the period following dissociation.

Under the current provisions, there is in effect a presumption that a member is entitled to access. Pursuant to the amendment, the net effect is that members are like shareholders and must demonstrate a proper purpose. It's as if the Act will now contemplate that the LLC will be managed by managers. But it can still be member-managed. In such a case, the operating agreement should clearly provide for unconditional member access to all information

The following is the bare-bones disclosure to which a transferee is entitled:

§ 1–40. Records to be kept.

(a) Each limited liability company shall keep at the principal place of business of the company named in the articles of organization or other reasonable locations specified in the operating agreement all of the following:

(1) A list of the full name and last known address of each member setting forth the amount of cash each member has contributed, a description and statement of the agreed value of the other property or services each member has contributed or has agreed to contribute in the future, and the date on which each became a member.

(2) A copy of the articles of organization, as amended or restated, together with executed copies of any powers of attorney under which any articles, application, or certificate has been executed.

(3) Copies of the limited liability company's federal, State, and local income tax returns and reports, if any, for the 3 most recent years.

(4) Copies of any then effective written operating agreement and any amendments thereto and of any financial statements of the limited liability company for the 3 most recent years.

(b) Records kept under this Section may be inspected and copied at the request and expense of any member or legal representative of a deceased member or member under legal disability during ordinary business hours.

TAB 2

John L. Eisel is a Partner in the Chicago office of Locke Lord LLP and co-chair of the Firm's Private Equity & Venture Capital group. John is both a lawyer and CPA with more than 30 years of experience. He acts as lead counsel for several private equity companies and corporate clients and is a director on a number of boards. He earned his B.S. (*summa cum laude*) at the University of Illinois and his J.D. (*magna cum laude*) at the University of Illinois College of Law.

Steve G. Frost retired in 2016 from the law firm of Chapman and Cutler LLP, where he was a partner in the Chicago office. From September, 2008 through October, 2009 he was a Senior Counsel in the Office of Tax Policy at the Department of the Treasury. He is a Commissioner from the State of Illinois to the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and a past member of its Executive Committee; he is Chair of a current project to draft a Uniform LLC Series Act and a member of its Joint Editorial Board on Uniform Unincorporated Organization Acts; and he was an ABA Tax Section Advisor to or a member of the NCCUSL drafting committees that drafted the revised Uniform Limited Liability Company Act, the Limited Liability Partnership amendments to the Uniform Partnership Act, the Revised Uniform Limited Partnership Act, and the Model Entities Transactions Act. Mr. Frost is a member of the Institute on Illinois Business Law. He was an Adjunct Professor, Kent College of Law Masters of Taxation Program from 2001 through 2012, and he is a Fellow of The American College of Tax Counsel. He has also been elected to membership in the American Law Institute. He is Vice-President of the School Board of Stevenson High School District 125. He is a past chair of the following committees: ABA Tax Section Partnership and LLC Committee, ABA Task Force on Limited Liability Companies, the Chicago Bar Association Business Section's Subcommittee on Noncorporate Entities, the Federal Tax Committee of the Chicago Bar Association and that Committee's Subcommittee on Partnerships, Real Estate and Tax Sheltered Investments. Mr. Frost has published various articles on partnership and investment related issues in, for example, the Business Lawyer, the Journal of Taxation, the Journal of Real Estate Taxation, Taxes Magazine, Tax Notes, the Journal of Limited Liability Companies, the Illinois Bar Journal and the Journal of Passthrough Entities, and he has spoken nationally on a variety of investment and business law related topics. Mr. Frost received a B.A. and B.S. from the University of Colorado and a J.D. with Honors and M.S. in Accountancy with Distinction from DePaul University. Mr. Frost is also a Certified Public Accountant in Illinois.

Philip N. Hablutzel is Professor Emeritus at Chicago-Kent College of Law and remains there as the Director of the Institute of Illinois Business Law.

He has a B.A. from Louisiana State University and a Masters Degree from the University of Chicago, both in Political Science. He has J.D. from the University of Chicago Law School (1967).

He joined the Faculty of Chicago-Kent in 1971, and taught courses in Corporations, Securities Regulation, Banking Law, and Trusts. He founded Kent's LL.M Program in Financial Services Law in 1985 and was its Director until 1996. He was a member of the Illinois Secretary of State's Corporation Acts Advisory Committee from 1986 until 2005, when it transformed into the Institute of Illinois Business Law, since then located at Kent with Prof. Hablutzel as its Director. For that organization, he was the Reporter for the revision of the Illinois Not For Profit Corporation Act. His major publications include The Model Business Corporation Act Annotated (3 vols, 1971) and International Banking Law (2 vols, 1994).

Since 2004, he has been a member of the Business Conduct Committee of the Chicago Board Options Exchange.

Robin Heiss practiced for over 40 years as a business lawyer in Chicago, Illinois, most recently as a partner of Reed Smith LLP. Now retired.

Representative Matters

Advised clients starting new businesses in the selection of the appropriate business entity; in the planning and preparation of stockholder agreements, buy/sell agreements, limited liability company operating agreements, partnership agreements and limited partnership agreements; and in planning for growth and succession.

Represented sellers and buyers of privately held businesses in stock transactions, asset transactions and mergers.

Structured and negotiated joint ventures and strategic alliances, both domestically and internationally.

Counseled owners and management of privately held companies with regard to fiduciary duties, statutory compliance, rights of minority investors, corporate "freeze-outs" and dissenters' rights.

Prepared and negotiated a wide variety of commercial contracts, such as sales agreements, services agreements, indemnification agreements, distributor agreements, license agreements, employment and consulting agreements, and phantom equity agreements.

Degrees

J.D., New York University School of Law

A.B., University of Chicago

Professional Affiliations

Member, the Institute of Illinois Business Law, 2005 – present, and its predecessor organization, the Illinois Secretary of State's Corporate Acts Advisory Committee, 1989 – 2005.

Former Member, Chicago Bar Association. and past Chair of its Corporation and Business Law Committee.

Former Member, American Bar Association, and Sections on Business Law and Individual Rights and Responsibility

Former Member, TriBar Opinion Committee – a multi-bar group that has published several major reports on third-party legal opinion letters.

Charles W. Murdock is one of the leading scholars and experts in Illinois corporate law and other business organizations. He recently completed the second edition of his treatise on Illinois Business Organizations for West Publishing Company and previously served as the technical editor for the ABA's publication, The Business Lawyer.

Professor Murdock was the draftsman for the 1983 Illinois Business Corporation Act, and on the committee that revised the Illinois Limited Liability Act. When the Uniform Limited Liability Company Act, the Uniform Partnership Act (1997) and the Uniform Limited Partnership Act (2001) were adopted in Illinois, he was the leading voice in modifying these acts so that the enumeration of fiduciary duties would not be exclusive. He also argued against exclusivity in a 2001 article in the Business Lawyer. The Commissioners on Uniform Laws have now recognized, in the new version of the Uniform Limited Liability Act, that it was not possible to "cabin" the concept of fiduciary duty in the language they had employed and have now eliminated exclusivity.

His article in the 1990 Notre Dame Lawyer was the first to challenge the business valuators, who had been imposing discounts in valuing minority holdings in connection with "fair value" determinations in squeeze out mergers and valuation proceedings in connection with oppressive conduct. He testified in several court cases on this issue and his position was referenced in appellate opinions. This started a chain of judicial decisions rejecting the imposition of minority and liquidity discounts. His 2004 article in the Loyola Law Journal chronicled this development and included tables of the status of this issue in all jurisdictions that had dealt with this issue. This article lead to Illinois, which had been one of the holdout states, passing legislation rejecting these discounts.

Prior to serving as Dean at Loyola Law School (1975-1982), he taught at Notre Dame, where he established a Minority Enterprise Small Business Investment Company, the first MESBIC to be affiliated with a university and to be supported by faculty and graduate students. After serving as Dean, he was appointed Deputy Attorney General for the State of Illinois. In that capacity, he not only supervised the activities of the second largest and most diverse law firm in the state, but also argued cases in the Supreme Court of Illinois, the Appellate courts, and the Seventh Circuit and United States Supreme Court. He also has testified before the Senate Judiciary Committee and the Internal Revenue Service about critical issues in mass tort litigation.

Professor Murdock has been a participant in the Aspen Institute Law and Justice program, a panelist in the Allerton House Conference on Professional Responsibility, and has served as a member of the Board of Managers of the Chicago Bar Association and Chairman of the Illinois State Bar Association Council on Corporation, Securities, and Business Law. He has frequently served as an expert witness and as a special master for the District Courts for the Northern District of Illinois. In 1991, he co-founded the Loyola Family Business Program, a membership forum of many of the most significant family businesses in the Midwest, which provides educational programs and small group support programs akin to the Young Presidents' Organization.

Professor Murdock has also been recognized in Who's Who in America.

Cory White specializes in general business representation, transactional drafting, and securities compliance. He received his B.A. from Georgetown University in Washington, DC and his J.D. from DePaul University College of Law in Chicago, IL. Cory has been involved in structuring both for-profit and nonprofit entities to ensure that the business needs of the client are properly met. His most prominent area of expertise is in securities compliance and regulation, particularly the private placement of securities and the solicitation of proxies.

Cory served as the past Chair of the ISBA the Business and Security Law Section Council, is the current Chair of the ISBA Diversity Leadership Council, and is currently an ISBA Delegate to the American Bar Association.

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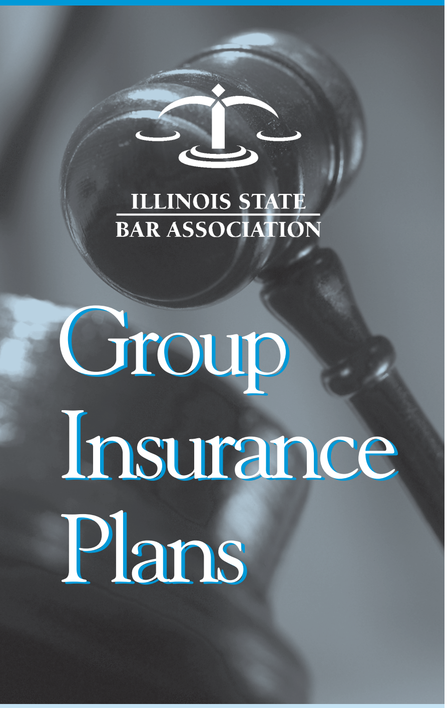

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[1] *Genworth Financial Cost of Care Survey 2010*

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