



# Limited Liability Companies in Kansas\*

by Edwin W. Hecker Jr.

## **About the Author**

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**T**he Kansas Limited Liability Company Act (the Act)<sup>1</sup> is now over three years old and has been amended twice since its original enactment in 1990.<sup>2</sup> The Act authorizes creation of a relatively new form of business organization, a limited liability company (LLC), which offers the possibility of combining the limitation on individual liability normally associated with the corporate form with the conduit tax treatment of items of income, gain, loss, deduction and credit normally associated with the partnership form.

The purpose of this article is to discuss generally the main provisions of the Act as they relate to the creation, operation and dissolution of an LLC in Kansas. I shall not attempt to discuss the taxation of LLCs, because those matters have been ably treated elsewhere.<sup>3</sup> It should be noted, however, that although the Act states that an LLC is a separate legal entity but is not a corporation,<sup>4</sup> this characterization is not conclusive for federal income tax purposes. Rather, an LLC will be classified for tax purposes either as a partnership or as an association taxable as a corporation, depending on how many of the corporate characteristics of continuity of life, free transferability of interests, centralization of management and limited liability it has.<sup>5</sup>

## ORGANIZATION

### General Requirements

**Name.** The name of each LLC must contain the words "limited company" or "limited liability company" or the abbreviations "L.C." or "L.L.C."<sup>6</sup> Failure to use one of these suffixes, which are intended to put the public on notice of the limited individual liability of the members, will make any member who actively participates or knowingly acquiesces in the omission liable for any indebtedness, damage or liability occasioned by the omission.<sup>7</sup> In addition, the name chosen by an LLC must be such as to distinguish it on the secretary of state's records from the names of other domestic or foreign corporations, limited partnerships or LLCs, unless the other organization waives this requirement in writing.<sup>8</sup> Finally, a name may be reserved in the same way corporate names are reserved.<sup>9</sup>

**Registered Office and Resident Agent.** Every LLC must maintain in Kansas a registered office and designate a resident agent for service of process.<sup>10</sup> The registered office may, but need not be, the same as the LLC's place of business, and the resident agent may be an individual, a Kansas corporation or the LLC itself.<sup>11</sup> The address of its registered office and the name and address of its initial resident agent must be contained in the LLC's articles of organization.<sup>12</sup> Changes in the LLC's registered office or resident agent generally may be made merely by the agent's filing a certificate reflecting the change with the secretary of state, in which event formal amendment of the articles is unnecessary.<sup>13</sup> If, however, the resident agent resigns without appointing a successor, or if the agent dies or moves from the LLC's registered office without designating a new resident agent, the LLC must promptly designate a new agent or face cancellation of its articles of organization.<sup>14</sup>

**Permitted Businesses and Purposes.** Except as otherwise provided by Kansas law, an LLC may engage in any lawful business, trade, occupation or profession that a partnership or an individual may conduct or promote.<sup>15</sup> This broad grant of authority specifically includes the

practice of a profession and the employment of professionals,<sup>16</sup> but specifically excludes, with certain exceptions, the ownership or leasing of agricultural land in Kansas.<sup>17</sup>

### Filing Requirements

**General Filing and Signature Requirements.** The original signed copy and a duplicate copy of an LLC's articles of organization, any certificate of amendment to the articles, and, at the appropriate time, the statement of intent to dissolve and the articles of dissolution must be filed with the secretary of state. If the document conforms to law, and if the required filing fees are paid, the secretary of state must certify that the document has been filed by endorsing the word "filed" and the date and hour of filing on the original; file and index the original; and certify the duplicate and return it to the person who submitted it for filing. Absent actual fraud, the secretary of state's endorsement is conclusive evidence of the date and time of the document's filing.<sup>18</sup>

Any of these documents may be signed by an attorney-in-fact pursuant to a power of attorney. In such cases, the power need not be exhibited or filed with the document, but it must be retained by the LLC.<sup>19</sup> No filed document is required to be sworn to, but execution by a member constitutes an oath or affirmation under penalty of perjury that the facts stated in the document are true and that any power of attorney used in connection with the execution of the document is in proper form and substance.<sup>20</sup>

Any document required by the Act to be filed with the secretary of state's office may be filed by telefacsimile communication, and, if it is accompanied by the appropriate fees and meets the statutory requirements, it is effective on its filing date. However, the original document must be filed within seven days after the telefacsimile filing date. Failure to file the original within that seven-day period voids the telefacsimile filing, and the instrument will not be effective until the original is filed.<sup>21</sup>

The fact that an LLC's articles of organization are on file in the secretary of state's office constitutes notice for all purposes with respect to matters required to be set forth in the articles.<sup>22</sup>

### FOOTNOTES:

\*This article is based on a chapter of *State Limited Liability Company Laws*, published by Prentice Hall Law & Business.

1. K.S.A. 1993 Supp. 17-7601 to -7652.

2. 1990 Kan. Sess. Laws, ch. 80; 1991 Kan. Sess. Laws, ch. 76; 1993 Kan. Sess. Laws, ch. 96.

3. See Martin, *The Kansas Limited Liability Company Act*, 59 J. Kan. B.A. 17 (Oct. 1990).

4. K.S.A. 17-7603(b).

5. Treas. Reg. § 301.7701-2; Martin, *supra* note 3, at 20-21. See also Hecker, *The Tax Classification of Limited Partnerships Revisited*, 88 Comm. L.J. 537 (1983).

6. K.S.A. 17-7606(a).

7. K.S.A. 17-7606(b).

8. K.S.A. 17-7606(a).

9. K.S.A. 17-7633.

10. K.S.A. 17-7611(a).

11. *Id.*

12. K.S.A. 17-7607(a)(4).

13. K.S.A. 17-7611(b), (c).

14. K.S.A. 17-7611(d), (e).

15. K.S.A. 17-7602(f), -7603(a). The original Act permitted an LLC to conduct or promote any lawful business that a general corporation or partnership could conduct or promote. 1990 Kan. Sess. Laws, ch. 80, § 3. The present version, which deletes "general corporation" and adds "individual," was adopted in 1991. See 1991 Kan. Sess. Laws, ch. 76, § 13.

16. K.S.A. 17-2708, -7604(q); 26 Op. Att'y Gen. 9, No. 92-23 (1992).

17. K.S.A. 17-5902 to -5904. The original Act contained a blanket prohibition on the ownership or leasing of agricultural land by an LLC. 1990 Kan. Sess. Laws, ch. 80, § 51. However, LLCs were melded into the general Agricultural Corporation Act in 1991, and the blanket prohibition was repealed. 1991 Kan. Sess. Laws, ch. 76, §§ 9, 10, 29. See also 25 Op. Att'y Gen. 51, No. 91-133 (1991).

18. K.S.A. 17-7608(a).

19. K.S.A. 17-7608(a), -7634(b).

20. K.S.A. 17-7634(c).

21. K.S.A. 17-7652.

22. K.S.A. 17-7610(c).

**Formation by Filing Articles of Organization.** Any person<sup>23</sup> may form an LLC, which must have at least two members, by executing and filing articles of organization with the secretary of state.<sup>24</sup> The articles may be signed by the person forming the LLC, or by any member or manager,<sup>25</sup> and must set forth: (a) the name of the LLC; (b) the period of its duration, or the latest date upon which it is to dissolve; (c) the purpose or purposes for which the LLC is organized; (d) the address of its registered office and the name and address of its initial resident agent; (e) the right, if given, of members to admit additional members and the terms and conditions of admission; (f) the right, if given, of the remaining members to continue the business on the death, retirement, resignation, expulsion, bankruptcy, dissolution or occurrence of any other event that terminates the continued membership of a member in the LLC; (g) with respect to management: (i) if the LLC is to be managed by managers, a statement to that effect and the names and addresses of the initial managers, or (ii) if management is reserved to the members, the names and addresses of the members; and (h) any other provisions, not inconsistent with law, that the members desire for the regulation of internal affairs, including any provisions that the Act requires or permits to be contained in the LLC's operating agreement.<sup>26</sup> The Act affirmatively grants each LLC a broad range of powers (similar to corporate powers),<sup>27</sup> none of which are required to be stated separately in the articles.<sup>28</sup>

An LLC is considered organized upon the filing of its articles of organization, and, except as against the state in a direct attack on its status, the filed articles are conclusive evidence that all conditions precedent have been met and that the LLC has been legally organized.<sup>29</sup> Prior to filing its articles, the only business an LLC may transact is that which is incidental to its organization or to obtaining subscriptions for or payment of contributions to capital.<sup>30</sup> Those who violate this proscription are in jeopardy of joint and several individual liability.<sup>31</sup>

Although normally an LLC's existence commences on the date its articles of organization are filed by the secre-

tary of state, the articles may specify an earlier effective date, the date of subscription, if that date is not more than five days before the articles are actually filed.<sup>32</sup> Note, however, that the prohibition on premature commencement of business described in the preceding paragraph is phrased in terms of the time the articles are filed and not the time existence is deemed to begin. In other words, even in situations in which the articles retroactively cause the LLC's existence to be deemed to have begun five days before the actual filing date, the general prohibition on transacting business nevertheless appears to be literally applicable during such five-day period.

The articles of organization may also specify a delayed effective date, which cannot be more than 90 days after the filing date.<sup>33</sup>

**Operating Agreement.** The Act requires an LLC to have an operating agreement,<sup>34</sup> but unlike the articles of organization, the operating agreement is a private, internal document rather than a publicly-filed one. This agreement is the LLC analogue of a partnership agreement or corporate bylaws.<sup>35</sup> The Act states that the operating agreement must provide for the location of the LLC's principal office and for meetings of members and managers, if any. Other than this, however, the specific content of the operating agreement is largely unmandated. The Act merely provides that the operating agreement must be adopted by the members; that it governs the rights, duties and obligations of the members and managers, if any; and that it may contain any provisions for the regulation and management of the LLC's affairs that are not inconsistent with law or the articles of organization.<sup>36</sup> In fact, the Act does not even explicitly call for a written agreement, although it would be foolish not to reduce any such agreement to writing.<sup>37</sup>

**Amendments and Restatements of the Articles of Organization.** The articles of organization of an LLC must be amended when: (a) there is a change in the LLC's name; (b) there is a substantial change in the character of the business; (c) there is a false or erroneous

23. "Person" includes not only individuals but also general partnerships, limited partnerships, limited liability companies, trusts, estates, corporations and other associations. K.S.A. 17-7602(d).

24. K.S.A. 17-7605.

25. K.S.A. 17-7634(a)(1). Prior to 1993, all members were required to sign the articles of organization. See 1990 Kan. Sess. Laws, ch. 80, § 34.

26. K.S.A. 17-7607(a). The original version of the Act imposed a 30-year limit on the duration of an LLC and required articles of organization to state the capital contributions made and to be made by the members. See 1990 Kan. Sess. Laws, ch. 80, § 7. These provisions were deleted in 1991. See 1991 Kan. Sess. Laws, ch. 76, § 17.

27. K.S.A. 17-7604.

28. K.S.A. 17-7607(b).

29. K.S.A. 17-7609(a).

30. K.S.A. 17-7609(b).

31. See K.S.A. 17-7621, discussed in text at notes 87-96 *infra*.

32. K.S.A. 17-7609(c)(1). The reference in the Act to "the date of subscription" is somewhat obscure. It could mean either the date of subscription (i.e., execution) of the articles or the date on which subscriptions for capital contributions are received. The only other place in which the Act uses any form of the word "subscription" is in the immediately preceding

subsection, and it is used there in the second sense: "subscriptions for or payment of contributions." K.S.A. 17-7609(b). This close proximity suggests a similar usage in subsection (c)(1). On the other hand, section 17-7609 is derived from the Florida Limited Liability Company Act, which more clearly indicates that the intended reference is to the date the articles are executed. See Fla. Stat. §§ 608.405, .409(3)(a): "Two or more persons may form a limited liability company by executing, acknowledging, and delivering . . . articles of organization . . ." and "the date of subscription and acknowledgment."

33. K.S.A. 17-7609(c)(2).

34. K.S.A. 17-7613.

35. The original version of the Act actually used the term "bylaws." See 1990 Kan. Sess. Laws, ch. 80, § 13.

36. K.S.A. 17-7613.

37. The original version of section 17-7613 required "written bylaws." See 1990 Kan. Sess. Laws, ch. 80, § 13. In 1991, "bylaws" was changed to "operating agreement" and the term "written" was deleted, presumably intentionally. See 1991 Kan. Sess. Laws, ch. 76, § 21. It should be noted, however, that the operating agreements of many LLCs would fall under the Statute of Frauds as agreements not to be performed within one year. See K.S.A. 33-106.



statement in the articles; (d) there is a change in the time stated for dissolution; (e) a time for dissolution is fixed when no time previously had been specified; (f) the members wish to change any other statement so that the articles accurately represent the agreement between them; or (g) with respect to management: (i) management has been vested in a member who becomes disassociated from the LLC, or (ii) new managers are chosen.<sup>38</sup>

With respect to the last item listed above, changes in managerial personnel, the Act seems underinclusive. It appears to call for an amendment only in two instances: (a) management is by the members and a member is disassociated from the LLC; or (b) management is vested in managers and one or more new managers are selected. The Act does not clearly speak to at least two other commonplace situations: (a) management is by the members and a new member is added without the disassociation of any existing member;<sup>39</sup> or (b) management is vested in managers and a manager becomes disassociated from the LLC without the selection of any new managers.<sup>40</sup> If it is recalled that members must be identified in the articles of organization only when management is by the members, and alternatively, managers must be listed when management is by managers,<sup>41</sup> good practice would call for an amendment whenever any person vested with managerial authority becomes associated with or disassociated from the LLC.

Although the Act requires that an amendment be filed to correct a false or erroneous statement in the articles of organization, it provides no express civil liability for such false or erroneous statements.<sup>42</sup> It should be noted, however, that execution of any certificate by a member of an LLC constitutes an oath or affirmation, under penalties of perjury, that the facts stated in the certificate are true.<sup>43</sup>

There are no specific requirements as to the form or content of a certificate of amendment, although obviously it should identify the LLC by name and set forth the terms of the amendment to the articles of organization.<sup>44</sup> The certificate of amendment must be signed by all members, including any new member designated as such in the amendment,<sup>45</sup> and must be filed with the secretary of

state.<sup>46</sup> The articles of organization are amended upon such filing or upon any future effective date stated in the certificate of amendment.<sup>47</sup>

The Act also authorizes the use of restated articles of organization to integrate the initial articles and all subsequent amendments into a single document and, if desired, to amend further the articles of organization.<sup>48</sup> Restated articles must be specifically designated as either "restated articles of organization" or as "amended and restated articles of organization," depending on whether or not they further amend the articles. In addition, they must state: (a) the LLC's present name; (b) its original name, if different; and (c) the date the original articles were filed with the secretary of state.<sup>49</sup> The Act does not specifically address who must execute restated articles,<sup>50</sup> but the requirements governing certificates of amendment should apply.<sup>51</sup> In any event, restated articles of organization must be filed with the secretary of state and, except for the original effective date of the LLC's formation, upon such filing supersede the original articles and all previous amendments.<sup>52</sup>

***The Act does not specifically address who must execute restated articles, but the requirements governing certificates of amendment should apply.***

### **Capital Contributions**

**Form of Contribution.** Although it contains no provision purporting to regulate directly the qualitative form of members' contributions to the capital of an LLC, the Act indirectly speaks to this issue by defining "contribution" as "cash, other property, the use of property, services ren-

51. The conclusion in text that the signature requirements for certificates of amendment should also apply to restated articles of organization is derived as follows. First, a certificate of amendment is the document most closely related in scope and function to restated articles of organization (see specifically "amended and restated articles of organization"). Second, prior to 1993 all filed documents were required to be signed by all members. In 1993, this requirement was relaxed for initial articles of organization but not for any other documents. 1993 Kan. Sess. Laws, ch. 97, § 6. In addition to all existing members, a certificate of amendment must be signed by any new member designated as such in the certificate. K.S.A. 17-7610(b), -7634(a)(2). Compliance with these requirements, therefore, will constitute compliance with the most stringent signature requirements in the Act. Finally, the Kansas Revised Limited Partnership Act contains an analogous section authorizing restated certificates of limited partnership. See K.S.A. 56-1a160. This section, which is the model for the Act's provision for restated articles, expressly includes signature requirements that are identical to the requirements for amendments to the certificate of limited partnership. See K.S.A. 56-1a154(a)(2), -1a160(b). It is likely the legislature intended parallel treatment for LLCs but failed to include an express provision through oversight.

52. K.S.A. 17-7635(b),(d).

38. K.S.A. 17-7610(a).

39. Other provisions of the Act could be read as implying a duty to amend in this situation. See K.S.A. 17-7610(b) (amendment adding a new member must be signed by new member), -7634(a)(2) (same), -7634(c) (power of attorney to sign a certificate relating to the admission of a member must describe the admission). This situation could be brought within the scope of K.S.A. 17-7610(a)(7)(B) by construing its reference to "new managers" as including new member-managers.

40. If the outgoing manager is not also a member, no amount of construction can bring this case within the ambit of the duty to amend imposed by K.S.A. 17-7610(a)(7).

41. K.S.A. 17-7607(a)(7).

42. Compare K.S.A. 56-1a157 (applying to limited partnerships).

43. K.S.A. 17-7634(c).

44. Cf. K.S.A. 56-1a152(a) (applying to limited partnerships).

45. K.S.A. 17-7610(b), -7634(a)(2).

46. K.S.A. 17-7608(a).

47. K.S.A. 17-7608(b).

48. K.S.A. 17-7635(a).

49. K.S.A. 17-7635(b),(c).

50. See K.S.A. 17-7634(a).

dered, or any other valuable consideration transferred to the limited liability company as consideration for or on account of an interest in the limited liability company.<sup>53</sup> The most notable thing about this definition is that it specifically authorizes acquisition of a capital interest in exchange for past services but not in exchange for a binding obligation to perform future services. In making this distinction, the legislature apparently chose to follow the model of the General Corporation Code<sup>54</sup> rather than the Revised Uniform Limited Partnership Act<sup>55</sup> or the Delaware Limited Liability Company Act,<sup>56</sup> both of which expressly permit contributions of a binding obligation to perform future services.<sup>57</sup>

**Liability for Contributions.** A member of an LLC is liable to the LLC for the difference between the member's actual contributions to capital and the amount stated in the articles of organization<sup>58</sup> or other contract<sup>59</sup> as having been made.<sup>60</sup> A member also is liable to the LLC for any unpaid contribution that the member, in the articles of organization or other contract, agreed to make in the future, at the time and on the conditions stated in the articles or contract.<sup>61</sup> Finally, a member holds in trust for the LLC any specific property stated in the articles of organization or other contract as having been contributed by the member but which was not actually contributed.<sup>62</sup>

These liabilities with respect to the making of capital contributions may be waived or compromised, but only with the consent of all members.<sup>63</sup> Notwithstanding any

such waiver or compromise, however, a creditor of the LLC who extends credit or otherwise acts in reliance on the original obligation may enforce that original obligation.<sup>64</sup>

## OPERATION

### Members

**Rights of Members.** A member of an LLC is a person who has been admitted to the LLC in accordance with the Act, the articles of organization and the operating agreement.<sup>65</sup> With a very few exceptions considered subsequently, the Act does not attempt to delineate in detail the rights of the members, *inter se*, of an LLC. Rather, it simply provides that an LLC must have an operating agreement which must be adopted and approved by the members. This agreement governs the rights, duties and obligations of the members and managers, if any, and may contain any provisions for the regulation and management of company affairs that are not inconsistent with law or the articles of organization.<sup>66</sup> Thus, it is left to the drafting attorney to consider and provide affirmatively for such things as records to be kept and members' access to and inspection and copying of those records.<sup>67</sup>

The Act does state, however, that, except as provided in the operating agreement, a member may lend money to and transact other business with the LLC and, subject to other applicable law, will have the same rights and obligations with respect thereto as a person who is not a mem-

53. K.S.A. 17-7602(i). This provision was added in 1991. 1991 Kan. Sess. Laws, ch. 76, § 12. The original version of the Act did not purport to regulate explicitly the form of contributions, by definition or otherwise. *But see* Martin, *supra* note 3, at 18.

A detailed explication of the impact of the federal and state securities laws on the organization of an LLC obviously is beyond the scope of this article. It might be noted briefly, however, that an interest in a particular LLC may or may not be a "security" depending on whether it constitutes an "investment contract," as defined in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), and refined by subsequent case law. The primary inquiry is whether a person has invested in a common enterprise with the expectation of profits to be derived from the entrepreneurial or managerial efforts of others. *Id.* at 301. *See also United Housing Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975). The problematic, and variable point, of course, is whether a member of an LLC expects to derive profits principally from the efforts of others, or, at least in significant part, from the member's own efforts and input. If the LLC is to be managed by managers, *see* K.S.A. 17-7607(a)(7)(A), -7612; text at notes 115-19 *infra*, the interests acquired by non-managing members will constitute investment contracts, and thus, securities. If, however, the LLC is to be managed directly by its members, *see* K.S.A. 17-7607(a)(7)(B), -7612; text at notes 107-14 *infra*, the interests of the members are not likely ever to meet the test for an investment contract as presently applied to interests in general partnerships (the most closely analogous situation) in the Tenth Circuit. *See Banghart v. Hollywood General Partnership*, 902 F.2d 805, 808 (10th Cir. 1990) ("there must be evidence that the governing partnership agreement did not...afford general partners their customary powers or that general partners had been, or would be, prevented from exercising those powers").

In cases in which interests in an LLC are securities, the issuer must comply with federal and state registration and disclosure requirements unless an exemption can be found. At the federal level, Regulation D provides several exemptions that should obviate the necessity of registration in most cases. *See* 17 C.F.R. §§ 230.501 to .508. At the state level, several exemptions also are available. *See, e.g.,* K.S.A. 17-1262(l),(m); Kan. Admin. Regs. 81-5-6. In this regard, it is noteworthy that, as of July 1, 1993, the

exemption under section 17-1262(l) applies uniform standards to issuers that are corporations, limited partnerships or LLCs. All of these exemptions, of course, are exemptions only from the registration requirements, and not also from the antifraud provisions found in both federal and state law. There are no exemptions that condone fraud.

54. K.S.A. 17-6402.

55. K.S.A. 56-1a101(b), -1a30 1.

56. Del. Code Ann., tit. 6, §§ 18-101(3), -501.

57. It might be argued that an obligation to perform future services is covered by the general phrase "any other valuable consideration." The specificity with which the Act speaks only of "services rendered," and the clarity and precision with which the Limited Partnership Act and the Delaware LLC statute authorize future services, militates against such a strained construction. If an obligation to perform future services is to be authorized for Kansas LLCs, a statutory amendment is in order.

58. The 1990 version of the Act required the articles of organization to state the members' capital contributions and also any agreements to make additional contributions in the future. *See* 1990 Kan. Sess. Laws, ch. 80, § 7. Although these statements concerning capital contributions were eliminated as requirements in 1991, *see* 1991 Kan. Sess. Laws, ch. 76, § 17, they still may be included in an LLC's articles as optional provisions. *See* K.S.A. 17-7607(a)(8).

59. The terminology "other contract," the origin of which is unclear, is broader than but inclusive of an LLC's operating agreement.

60. K.S.A. 17-7619(a)(1).

61. K.S.A. 17-7619(a)(2).

62. K.S.A. 17-7619(b)(1).

63. K.S.A. 17-7619(c).

64. *Id.*

65. K.S.A. 17-7602(h).

66. K.S.A. 17-7613.

67. The rights of limited partners under the Kansas Revised Limited Partnership Act, section 56-1a205, provide a good starting point. *Compare* Del. Code Ann., tit. 6, § 18-305 (access to information and records by members and managers of Delaware LLCs).

ber.<sup>68</sup> This provision, which has been borrowed from limited partnership law,<sup>69</sup> allows members to deal with their LLC and, as a general proposition, to receive payment of any resulting claims on a parity with third-party creditors.

**Meetings and Voting.** In contrast to its open-ended flexibility about most internal rights of members, the Act contains relatively more detailed treatment of meetings of and voting by members. The original version of the Act required bylaws that provided for annual meetings of members for the election of managers, if any, and, regardless of whether the LLC had managers, for the election of a president and secretary.<sup>70</sup> These requirements were deleted in 1991.<sup>71</sup> The Act continues to require an operating agreement that provides for meetings of members or managers, if any, but the purposes of and intervals between meetings are no longer statutorily mandated.<sup>72</sup> Special meetings may be called by members holding not less than one-fifth of the voting power of the LLC or, if the power is given to them in the operating agreement, by the managers.<sup>73</sup> Regular meetings are to be held at the times prescribed in the operating agreement or upon not less than ten days' prior written notice to the members of record.<sup>74</sup> Special meetings may be called on not less than ten nor more than sixty days' prior written notice.<sup>75</sup> Notice of either type of meeting may be waived in writing.<sup>76</sup>

The presence at a meeting, in person or by proxy, of persons entitled to vote a majority of the voting interests of the LLC constitutes a quorum for the transaction of business.<sup>77</sup> Unlike its counterparts in the General Corporation Code,<sup>78</sup> the Act's quorum requirement is not expressly made subject to alteration by either the articles of organization or the operating agreement. The inflexibility exhibited by this quorum requirement is so out of keeping with the rest of the Act, and with business law in general, that perhaps the best explanation is simply legislative oversight.

If an LLC's business and affairs are being managed directly by its members, each member has one vote

unless the articles of organization or operating agreement provide otherwise.<sup>79</sup> This one-vote-per-member scheme is in contrast to that embodied in the original Act, which called for voting in proportion to the members' capital contributions unless otherwise provided in the articles.<sup>80</sup> Because both versions are default rules, the change from pro rata to per capita voting is significant only in the absence of advance planning. Other types of voting also appear to be validated by the Act's broad permission.

In contrast to its specific, and apparently immutable, quorum requirements, the Act is strangely silent regarding the number of votes necessary for the transaction of most business at members' meetings. The Act does require that a transaction not in the ordinary course of business be approved by a majority in number of the members, unless the articles of organization or operating agreement provide for a different vote.<sup>81</sup> Given this minimal, bare majority default rule for *extraordinary* transactions, one might reasonably inquire what the rule is, or ought to be, for *ordinary* transactions. Because the Act provides no answer to this question,<sup>82</sup> inclusion in the articles or operating agreement of voting requirements pertaining to ordinary business and also to other matters (*e.g.*, mergers) as to which the Act is silent is essential.

Finally, it should be noted that proxy voting is permit-

*... the Act is strangely silent regarding the number of votes necessary for the transaction of most business at members' meetings.*

acting alone, can bind the LLC to a transaction that constitutes apparently carrying on the business in the usual way unless the member in fact has no authority and the third party has knowledge of the lack of authority. K.S.A. 17-7614(b). Thus, the power of a member, viewed externally from a third party's vantage point, may not be coextensive with a member's authority viewed internally from the perspective of his or her fellow members. It is clear that any member generally will be able to commit the LLC to a transaction in the ordinary course of business. It is equally clear, however, that the members may agree that, among themselves, some specified number, fraction or percentage of the entire body must vote affirmatively to approve a given transaction or type of transaction. This limitation effectively will govern the rights and duties of the members, *inter se*. Whether it will affect the rights of third parties will depend on whether third parties have knowledge of the provision, and a member's lack of authority under the provision, in a given case. For present purposes, the point simply is that the Act does not, in section 17-7614(b), adopt a rule that the *vote* necessary to *authorize* a transaction in the ordinary course of business is "one." In fact, the Act does not speak to the issue. Compare K.S.A. 56-309 (the act of a general partner for apparently carrying on the partnership business in the usual way binds the partnership unless the partner in fact has no authority and the third party has knowledge of the lack of authority) with K.S.A. 56-318(e),(h) (unless otherwise agreed, all partners in a general partnership have equal rights in management, and differences as to ordinary matters are decided by majority vote). The Act has no counterpart to section 56-318(h).

68. K.S.A. 17-7613.

69. See K.S.A. 56-1a107.

70. See 1990 Kan. Sess. Laws, ch. 80, §§ 12, 13.

71. See 1991 Kan. Sess. Laws, ch. 76, §§ 20, 21.

72. See K.S.A. 17-7613.

73. *Id.*

74. It appears from the wording of the Act that notice of regular meetings is statutorily required only if the times for the meetings are not specified in the operating agreement.

75. K.S.A. 17-7613.

76. K.S.A. 17-7630.

77. K.S.A. 17-7613.

78. See K.S.A. 17-6301(b), -6506.

79. K.S.A. 17-7612.

80. See 1990 Kan. Sess. Laws, ch. 80, § 12.

81. K.S.A. 17-7614(d). This provision became effective July 1, 1993. The original version of the Act did not speak to this issue. See 1990 Kan. Sess. Laws, ch. 80, § 14. From July 1, 1991 to July 1, 1993, transactions not in the ordinary course of business had to be approved by a majority in interest of the members, and this requirement was not subject to change in the articles of organization or the operating agreement. See 1991 Kan. Sess. Laws, ch. 76, § 22.

82. It is important not to confuse the *power* of a member to bind the LLC to a transaction with a third party with the *authority* to do so. The Act provides that when management is vested in the members, any member,



ted, and that proxies generally have a three-year lifespan unless they specify a different duration.<sup>83</sup> Action by unanimous written consent without a meeting also is expressly authorized.<sup>84</sup>

**Liability.** As a general rule, the Act provides that neither the members nor the managers, if any, of an LLC are liable for the LLC's debts, obligations or liabilities.<sup>85</sup> The Act reinforces this substantive rule with a procedural provision stating that a member or manager is not a proper party to proceedings by or against an LLC except when the object is to enforce a member's or manager's rights against or liability to the LLC.<sup>86</sup>

This insulation from individual liability for enterprise obligations is, of course, one of the two most attractive features of the LLC form, the other being the possibility for taxation as a partnership. A member of an LLC, however, remains vulnerable to potential individual liability in at least three respects. The first relates to an improperly formed LLC, or to one that begins business before its articles are filed,<sup>87</sup> and flows from section 17-7621, which provides:

***A member of an LLC, however, remains vulnerable to potential individual liability in at least three respects.***

"All persons who assume to act as a limited liability company without authority to do so shall be jointly and severally liable for all debts and liabilities."<sup>88</sup> This ill-considered provision is a near-verbatim replica of section 146 of the original Model Business Corporation Act.<sup>89</sup> It was

intended to eliminate the case law doctrine of de facto corporations, at least when used by the stockholders of a defectively organized corporation as a defense to individual liability.<sup>90</sup> This same section has also been held to repeal the related defense known as "corporation by

estoppel."<sup>91</sup> Although the intent of section 146 may have been laudable, the lack of any explicit culpability requirement created the possibility that ruinous individual damages might be imposed on innocent, good faith investors in favor of third parties who in no way relied on such liability when dealing with the defective corporation and who were in no way caused harm by the defect in the corporation's status.<sup>92</sup> For this reason, the drafters of the Revised Model Business Corporation Act added the requirement that the defendants must know of the lack of incorporation before liability will be imposed.<sup>93</sup>

Although it is not completely clear how section 17-7621 found its way into the Act, especially in light of the absence of a similar provision in the General Corporation Code,<sup>94</sup> it is probable that the section is modeled after identical provisions in the Florida and Wyoming LLC statutes,<sup>95</sup> the only LLC legislation in effect when the Act was adopted in 1990. Unlike Kansas, however, both Florida and Wyoming at least had similar provisions, based on Model Act section 146, in their corporation codes.<sup>96</sup> As there seems little to recommend a rule that can impose individual liability on good faith, innocent investors who never agreed to such liability, and that can correspondingly grant windfall recoveries to third parties who never bargained for or expected such individual liability, section 17-7621 should be amended to make it clear that the defendants must know they lack authority to act as an LLC before they can be held jointly and severally liable.

Corporate law also is the source of the second potential threat to the limited liability of members of an LLC. Under the familiar doctrine known as "piercing the corporate veil" a court may disregard the separate entity of even a properly formed corporation if the corporation lacks independent economic viability and has been misused to the prejudice of creditors and others.<sup>97</sup> There is no reason to believe that this judicial exception to the limited liability of corporate stockholders will not be similarly engrafted onto the statutory limited liability of members of an LLC. After all, merely changing the form of artificial entity from corporation to LLC in no way changes the potential for abuse of the separate entity concept by unscrupulous

App. 2d 627, 631 P.2d 1240 (1981), the court of appeals held that K.S.A. 17-6003, -6005, -6006, which prescribe corporate filing requirements and define the time at which corporate existence begins, preclude the existence of either a de jure or de facto corporation prior to the time articles of incorporation are filed with both the secretary of state and the local register of deeds. Although the case severely restricted the realm within which the de facto doctrine could operate, it did not purport to abolish the doctrine. The somewhat parallel doctrine of corporation by estoppel was not involved in the decision. The practical effect of the *McCain* case, itself, was severely restricted by a 1987 amendment to section 17-6003(d). See 1987 Kan. Sess. Laws, ch. 89, § 1.

95. Fla. Stat. § 608.437; Wyo. Stat. § 17-15-133.

96. Fla. Stat. § 607.397, repealed by 1989 Fla. Laws, ch. 89-154, § 166 and 1990 Fla. Laws, ch. 90-179, § 189; Wyo. Stat. § 17-1-1007, repealed by 1989 Wyo. Sess. Laws, ch. 249, § 3. During 1989 and 1990, both states recodified their corporation laws, replacing the original Model Act with the Revised Model Act and its requirement of knowing conduct on the part of the defendants. Fla. Stat. § 607.0204; Wyo. Stat. § 17-16-204. Ironically, neither state has yet revised the corresponding section in its LLC statute.

97. See, e.g., *Kilpatrick Bros., Inc. v. Poynter*, 205 Kan. 787, 473 P.2d 33 (1970); *Kvassay v. Murray*, 15 Kan. App. 2d 426, 808 P.2d 896 (1991).

83. K.S.A. 17-7613.

84. *Id.*

85. K.S.A. 17-7620. See text at note 7, *supra*, for a discussion of liability that may be incurred by reason of failure to use an appropriate suffix in the LLC's name.

86. K.S.A. 17-7631.

87. See text at notes 29-33, *supra*.

88. K.S.A. 17-7621.

89. Model Bus. Corp. Act § 146.

90. *Id.* Comment.

91. E.g., *Robertson v. Levy*, 197 A.2d 443 (D.C. App. 1964); *Thompson & Green Mach. Co. v. Music City Lumber Co.*, 683 S.W.2d 340 (Tenn. App. 1984).

92. Ambiguities in the statutory language have afforded avenues of escape for certain stockholders. For example, if the term "act" is read to import active participation in the business rather than as a synonym for the verb, "be," mere passive investors will not be covered. *Timberline Equip. Co. v. Davenport*, 514 P.2d 1109 (Ore. 1973). In addition, "assume" may be read to require some degree of culpability. *Mobil Oil Corp. v. Thoss*, 385 So. 2d 726 (Fla. App. 1980).

93. Rev. Model Bus. Corp. Act § 2.04 & Comment.

94. In *State ex rel. McCain v. Construction Enterprises, Inc.*, 6 Kan.

operators, nor does it circumscribe the traditional equity jurisdiction of the judiciary.

The final threat to limited liability involves LLCs that operate across state lines in jurisdictions that do not have statutes authorizing the creation of this relatively new form of business organization. Will such a jurisdiction recognize the limited liability of the LLC's members, or will it treat them as general partners? This is a question of comity, as to which no single, definitive answer presently is possible.<sup>98</sup> It might be noted, however, that the significance of the problem is inversely related to the number of states that enact LLC legislation.<sup>99</sup>

**Admission of New Members and Transferability of Membership Interests.** It is apparent that any form of business organization may admit new members who acquire an equity interest in the enterprise either directly from the organization itself or by means of a transfer from an existing member. While less than a model of clarity, the Act speaks to both of these situations.

In regard to acquisition of an interest directly from the LLC, the Act requires the articles of organization to set forth the right, if given, of the members to admit additional members and the terms and conditions of such admissions.<sup>100</sup> From the language of the Act, it seems that admission of additional members must be addressed by the articles; there is no statutory authority for a provision regulating admission of additional members that appears only in the operating agreement. When one recalls that an amendment to the articles must be signed by all members,<sup>101</sup> it becomes clear that if the original articles of organization are silent on this issue, as a practical matter all members will have to be in agreement as a precondition to the admission of any additional members.

As to transfers from existing members, the Act provides that an interest in an LLC is personal property, transferable or assignable as provided in the operating agreement.<sup>102</sup> The Act goes on to state, however, that unless the other members of the LLC unanimously consent in writing to the proposed transfer or assignment, the transferee or assignee does not have the right to become a member of the LLC or to participate in management. Rather, the transferee or assignee receives only the economic rights (distributions of income and capital) of the transferor or assignor.<sup>103</sup> This language seems to contemplate an unwaivable specific consent requirement that must be satisfied for each and every proposed transfer or assignment. A blanket consent given in advance in the operating agreement would be sufficient to permit transfers of the economic rights flowing from an interest but

not the rights of full membership. Assuming the parties are willing to concede the tax classification characteristic of free transferability of interests,<sup>104</sup> no reason appears for statutory insistence on specific consent to each proposed transfer at the time the transfer is proposed. Therefore, the Act is in need of either a clarifying amendment<sup>105</sup> or liberal construction.

**Resignation and Termination of Membership.** The Act does not contain a separate exhaustive list of all the events that will terminate a person's membership in an LLC and the rights and obligations attendant on termination. It does, however, advert to some of the more common events that will cause termination in the sections governing, respectively, the contents of the articles of organization and events causing dissolution of the LLC, as follows: death, retirement, resignation, expulsion, bankruptcy, or dissolution of the member, or any other event that terminates continued membership.<sup>106</sup>

### Management

**Management by Members.** Unless otherwise provided in the articles of organization or the operating agreement, management of a Kansas LLC is vested in its members, whose names and addresses must be set forth in the articles.<sup>107</sup> As previously discussed, under this general norm each member has one vote, but this rule may be altered by appropriate language in either the articles of organization or the operating agreement.<sup>108</sup>

With respect to external business affairs, the Act adopts the general partnership scenario.<sup>109</sup> Thus, each member is statutorily constituted an agent of the LLC and given the power to bind it by any act (including execution of an instrument) for apparently carrying on in the usual way the business or affairs of the LLC, unless the member in fact lacks authority and the person with whom the member is dealing has knowledge that the member has no authority.<sup>110</sup> On the other hand, an act that is not for apparently carrying on the business in the usual way does

*The Act does not contain a separate exhaustive list of all the events that will terminate a person's membership in an LLC...*

98. See generally, Comment, *Limited Liability Companies*, 39 Kan. L. Rev. 967, 987-91 (1991).

99. The clear and accelerating trend is toward enactment. In 1990, Kansas was one of only four states that authorized creation of LLCs. As of late 1993, that number had increased to 35. See M. Bamberger & A. Jacobson, *State Limited Liability Company Laws* (1993).

100. K.S.A. 17-7607(a)(5).

101. K.S.A. 17-7610(b), -7634(a)(2).

102. K.S.A. 17-7617, -7618.

103. K.S.A. 17-7618.

104. See Treas. Reg. § 301.7701-2(e)(1).

105. See, e.g., Del. Code Ann., tit. 6, §§ 18-301(b)(2), -704(a). Similar provisions already apply to Kansas limited partnerships. K.S.A. 56-1a201(b)(2), -1a404(a).

106. K.S.A. 17-7607(a)(6), -7622(a)(3).

107. K.S.A. 17-7607(a)(7)(B), -7612.

108. K.S.A. 17-7612. See text at notes 79-80, *supra*.

109. See K.S.A. 56-309.

110. K.S.A. 17-7614(b).



not bind the LLC unless authorized in accordance with the articles of organization or operating agreement, either at the time of the transaction or at any other time.<sup>111</sup> In no event, however, will the act of a member in contravention of a restriction on the member's authority bind the LLC to persons having knowledge of the restriction.<sup>112</sup>

These rules, which, as noted, are modeled closely after the Uniform Partnership Act, were enacted in 1993 and are a vast improvement over previous versions of the Act.<sup>113</sup> If a business is to be managed in a decentralized fashion, directly by its owners, the forms of choice most often will be either a general partnership or an LLC. The

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relative importance or unimportance of limited liability typically will motivate the parties to choose one or the other of these forms. Regardless of the technical choice of form, however, the realities of the business and the participants remain the same. The general partnership rules, under which each partner is an agent with power to bind the partnership in ordinary business matters, have withstood the test of time and have acquired relatively settled meaning through decades of judicial interpretation throughout the United States.<sup>114</sup> It makes good sense to extend those rules to LLCs.

**Management by Managers.** The articles of organization of an LLC may vest management of the LLC in one or more managers, whose names and addresses must be set forth in the articles.<sup>115</sup> With respect to internal affairs, the Act is largely permissive, providing only that the man-

agers are to be chosen by the members in the manner prescribed by the articles or the operating agreement, and have the responsibilities given to them by the members in either of those same documents.<sup>116</sup>

As to external matters, the Act's provisions are the mirror image of those applicable to management by members. That is, every manager is an agent with the ability to bind the LLC to any transaction that constitutes apparently carrying on in the usual way the business or affairs of the company, unless in fact the manager has no authority to act and the third person has knowledge that the manager lacks authority.<sup>117</sup> Again, an act of a manager that does not constitute apparently carrying on the business in the usual way is not binding unless actually authorized pursuant to the articles of organization or operating agreement. Unless otherwise provided in either of those documents, such authority must flow from a majority in number of the members, not the managers.<sup>118</sup> Finally, and importantly, if the business is being managed by managers, no member, as such, is an agent of the LLC,<sup>119</sup> and thus, no member, as such, will have power to bind the LLC to any transaction whatsoever. Therefore, it is important for a third party to be at least minimally familiar with the management structure of an LLC, especially when the third party is dealing with a member, even if the transaction seems ordinary.

**Profits, Losses and Distributions**

**Allocation.** Distributions of cash or other assets of an LLC are allocated among the members, and among classes of members, in the manner provided in the articles of organization or the operating agreement. If the articles and operating agreement are silent, distributions are to be made equally to the members.<sup>120</sup> Items of income, gain, loss, deduction or credit are allocated in the manner provided in the operating agreement. If the agreement does not speak to allocation of these items, they are allocated among the members in the same proportions in which members share in distributions.<sup>121</sup>

111. K.S.A. 17-7614(d). Unless otherwise provided in the articles of organization or operating agreement, the authorization must be by a majority in number of the members. *Id.* See notes 81-82 and accompanying text, *supra*.

112. K.S.A. 17-7614(e).

113. The original version of section 17-7614 spoke only to execution of instruments by which an LLC acquired, mortgaged or disposed of property, and provided that such instruments were valid and binding if signed by one or more members of an LLC being managed by the members. See 1990 Kan. Sess. Laws, ch. 80, § 14. The 1991 amendment expanded the scope of coverage to include contracts in the usual course of business and provided that a transaction not in the ordinary course must be approved by a majority in interest of the members. See 1991 Kan. Sess. Laws, ch. 76, § 22.

114. Uniform Partnership Act § 9, upon which section 17-7614 is based, was promulgated in 1914 and, as recently as 1992, was the law in 49 of the 50 states. In 1992, the National Conference of Commissioners on Uniform State Laws promulgated a Revised Uniform Partnership Act which, as of August 1993, had been enacted in two states. Even the revised version, however, carries forward the substance, and most of the specific language, of the original. See Revised Uniform Partnership Act § 301.

115. K.S.A. 17-7607(a)(7)(A), -7612.

116. K.S.A. 17-7612.

117. K.S.A. 17-7614(c)(2). Unlike the subsection governing management by members, subsection (c)(2) does not expressly provide that an act for apparently carrying on the business in the usual way may include, but is not limited to, execution of an instrument. Compare K.S.A. 17-7614(b). In

the absence of evidence that this omission was other than inadvertent, the negative implication that managers may not effectively execute instruments in the ordinary course of business should not be drawn. Both the original version of the Act and the 1991 amendments treated members and managers identically in terms of their ability to execute documents and instruments on behalf of the LLC. 1990 Kan. Sess. Laws, ch. 80, § 14; 1991 Kan. Sess. Laws, ch. 76, § 22.

118. K.S.A. 17-7614(d). No act of a manager or other agent in contravention of a restriction on the authority of the manager or agent will bind the LLC to persons with knowledge of the restriction. K.S.A. 17-7614(e).

119. K.S.A. 17-7614(b),(c)(1).

120. K.S.A. 17-7615(b).

121. K.S.A. 17-7615(c). With respect to the document that may be used to vary the Act's default rules, section 17-7615 appears to differentiate between allocation of actual distributions and allocation of items of income, gain, loss, deduction or credit. It permits the former to be provided for in either the articles of organization or the operating agreement, while restricting allocations of the latter to the operating agreement. The discrepancy probably is the unintentional result of subsection (c) having been enacted in 1991 and subsection (b) having been enacted separately in 1993. See 1991 Kan. Sess. Laws, ch. 76, § 23; 1993 Kan. Sess. Laws, ch. 97, § 3. In any event, the discrepancy is harmless because the Act states that any provision required or permitted to be set forth in the operating agreement may alternatively be included in the articles of organization. K.S.A. 17-7607(a)(8).

**Interim Distributions.** An LLC may distribute cash or other assets on the basis provided in the operating agreement,<sup>122</sup> but only if, after the distribution, the LLC's assets exceed all of its liabilities, other than liabilities to members on account of their contributions.<sup>123</sup> A member who receives a distribution in violation of this balance sheet insolvency limitation will be liable to the LLC for three years for any amount (not greater than the distribution plus interest) necessary to discharge the LLC's liability to all creditors who extended credit or whose claims arose prior to the distribution.<sup>124</sup>

Unless the articles of organization or operating agreement provide otherwise, a member cannot demand that a distribution of assets be made in kind rather than in cash, and this remains true even if the member contributed particular property in kind to the LLC.<sup>125</sup> Conversely, unless the articles or operating agreement affirmatively permit it, a member also cannot be forced to accept a disproportionate distribution in kind, *i.e.*, one in which the percentage of the asset distributed to the member exceeds the proportion in which the member shares in distributions generally.<sup>126</sup>

**Returns of Capital Contributions.** Prior to dissolution of an LLC, a member may receive the return of part or all of the member's capital contribution only if: (a) all of the LLC's liabilities, except liabilities to members on account of their contributions, have been paid or there will remain sufficient property to pay them; and (b) either (i) all other members consent, (ii) the date or event specified in the articles of organization for the return of the contribution has arrived or occurred, or (iii) if the articles do not specify a time for dissolution of the LLC, the member has given all other members six months prior written notice.<sup>127</sup> Unless the articles of organization provide otherwise, or unless all other members consent, a member has no right to demand and receive a return of the member's capital contribution in any form other than cash, again regardless of the nature or form of the contribution when originally made.<sup>128</sup>

If a distribution, whether in cash or in kind, constitutes a wrongful return of part or all of a member's capital contribution, the member holds the cash or property wrongfully distributed in trust for the LLC.<sup>129</sup> Although this liability may be waived or compromised by the unanimous consent of the other members, no such waiver or compromise will prevent enforcement of the member's original obligation by a creditor of the LLC who extended

credit or otherwise acted in reliance on that obligation.<sup>130</sup> Moreover, even if a member has rightfully received a distribution constituting a return of part or all of the member's capital contribution, the member will remain liable to the LLC for one year for any amount (not greater than the amount returned plus interest) necessary to discharge the LLC's liability to all creditors who extended credit or otherwise acted in reliance on the member's original obligation to contribute capital.<sup>131</sup>

### Derivative Actions

The Act does not expressly permit a member to bring a derivative action on behalf of an LLC.<sup>132</sup> The Act does provide that a member or manager is not a proper party to proceedings by or against an LLC except when the object is to enforce a member's or manager's rights against or liability to the LLC.<sup>133</sup> This provision is derived from the original 1916 version of the Uniform Limited Partnership Act,<sup>134</sup> under which there was a diversity of view nationally on the question whether derivative actions were permitted. By the better view, this language was held not to prohibit a limited partner from instituting derivative litigation in appropriate circum-

*... this language was held not to prohibit a limited partner from instituting derivative litigation ...*

stances, but rather was interpreted primarily merely as a procedural counterpart to the substantive rule of law that limits a limited partner's individual liability.<sup>135</sup> Although the Act could be interpreted similarly, an amendment codifying the right of a member of an LLC to sue derivatively on its behalf would be preferable.<sup>136</sup>

## ORGANIC CHANGES

### Mergers

In authorizing mergers of LLCs, the Act's drafters drew directly on the limited partnership model,<sup>137</sup> with appropriate changes in language to adapt the framework to LLCs. Thus, pursuant to an agreement, an LLC may merge or consolidate with or into one or more other LLCs, either domestic or foreign.<sup>138</sup> A domestic LLC that does not survive the merger or consolidation must file articles of dissolution, effective not later than the merger or consolidation.<sup>139</sup>

122. See note 121, *supra*.

123. K.S.A. 17-7615(a).

124. K.S.A. 17-7619(e).

125. K.S.A. 17-7615(b).

126. *Id.*

127. K.S.A. 17-7616(a),(b).

128. K.S.A. 17-7616(c).

129. K.S.A. 17-7619(b).

130. K.S.A. 17-7619(c).

131. K.S.A. 17-7619(d).

132. Compare K.S.A. 56-1a551 to -1a554 (authorizing and regulating limited partners' derivative actions).

133. K.S.A. 17-7631.

134. Uniform Limited Partnership Act § 26 (1916). The Kansas version appears at K.S.A. 56-147, *repealed*, 1983 Kan. Sess. Laws, ch. 88, § 76.

135. Hecker, *Limited Partners' Derivative Suits Under the Revised Uniform Limited Partnership Act*, 33 Vand. L. Rev. 343, 351-53 (1980).

136. See Del. Code Ann., tit. 6, §§ 18-1001 to -1004, which provide for derivative actions by members of LLCs, and which obviously are based on the revised limited partnership model.

137. See K.S.A. 56-1a609.

138. K.S.A. 17-7650(a).

139. K.S.A. 17-7650(b).



Such articles of dissolution are the only formally filed document called for by the substantive provisions of the Act,<sup>140</sup> and upon their effective date, all of the assets and liabilities of each of the constituent LLCs become the assets and liabilities of the surviving or resulting LLC.<sup>141</sup> If the surviving

***Such articles of dissolution are the only formally filed document called for by the substantive provisions of the Act...***

or resulting LLC is foreign rather than domestic, it must consent to suit in Kansas and appoint the secretary of state as its agent for service of process.<sup>142</sup>

The Act does not attempt to dictate any of the provisions of an agreement of merger or consolidation, nor does it regulate the internal procedure by which such an agreement must be authorized and approved.<sup>143</sup> Finally, it should be noted that the Act only authorizes mergers and consolidations between and among LLCs. It does not speak to such business combinations with other forms of organizations.<sup>144</sup>

#### Conversions

The Act contains no special provisions designed to expedite the conversion of some other form of existing business organization, such as a general or limited partnership, into an LLC.<sup>145</sup>

## DISSOLUTION

### Causes of Dissolution

An LLC is dissolved: (1) when the period fixed for its duration expires; (2) by the unanimous written agreement of the members; or (3) upon the death, retirement, resignation, expulsion, bankruptcy, dissolution or occurrence of any other event that terminates the continued membership of a member, unless the business is continued either by the consent of all remaining members or under a right to do so stated in the articles of organization.<sup>146</sup> In addition, a member may have an LLC dissolved when: (1) the member has rightfully but unsuccessfully demanded the return of his or her capital contribution; or (2) the other liabilities of the LLC have not been paid and there is insufficient property for their payment, but the

member otherwise would be entitled to the return of his or her capital contribution.<sup>147</sup> Finally, an LLC is subject to involuntary dissolution by judicial decree, in an action brought by the attorney general, upon a showing that the LLC: (1) fraudulently procured its articles of organization; (2) exceeded its authority; (3) committed a violation of law which forfeits its articles of organization;<sup>148</sup> (4) conducted its business in a persistently fraudulent or illegal manner; or (5) abused its powers contrary to public policy, thus becoming liable to be dissolved.<sup>149</sup>

### Winding Up

**Statement of Intent to Dissolve.** In cases of non-judicial dissolution, as soon as possible after the event causing dissolution, the LLC must file with the secretary of state a statement of intent to dissolve signed by all remaining members.<sup>150</sup> In addition, the LLC must, within 20 days, mail notice of the filing of this statement to all of its creditors and claimants.<sup>151</sup>

Upon filing a statement of intent to dissolve, an LLC must cease carrying on its business except insofar as necessary for winding up. The LLC's separate existence, however, continues until the secretary of state issues a certificate of dissolution or until a judicial decree of dissolution is entered.<sup>152</sup>

**Liquidation and Distribution of Assets.** After filing the statement of intent to dissolve, the LLC must: (a) collect its assets; (b) dispose of any property not to be distributed in kind to the members; (c) pay or make provision for the payment of its liabilities; and (d) do anything else necessary to liquidate its business and affairs.<sup>153</sup> After paying or providing for its liabilities, the LLC may distribute its remaining assets, in cash or in kind, to its members.<sup>154</sup>

In settling accounts after dissolution, the liabilities of an LLC rank in the following order of priority: (a) liabilities to creditors, in the priority provided by law, except liabilities to members on account of their contributions; (b) liabilities to members with respect to profits and other income; and (c) liabilities to members with respect to their capital contributions.<sup>155</sup> In the event the LLC's assets are insufficient to permit payment in full, and subject to any contrary provision in the operating agreement,<sup>156</sup> members will share in assets with respect to their claims for capital and for profits or other income in proportion to the respective amounts of such claims.<sup>157</sup>

140. Curiously, the 1993 amendments added "a certificate of merger" to the section prescribing fees for filed documents but made no changes in the substantive filing requirements. K.S.A. 17-7646(a)(1)(F), *amended by* 1993 Kan. Sess. Laws, ch. 97, § 8.

141. K.S.A. 17-7650(d). Several lines apparently were inadvertently omitted in converting the limited partnership merger section to the LLC format. Compare K.S.A. 56-1a609(d). The obvious intent of the section is as described in the text.

142. K.S.A. 17-7650(c).

143. Compare Del. Code Ann., tit. 6, § 18-209.

144. Compare *id.*

145. Compare Va. Code §§ 13.1-1010.1 to -1010.2.

146. K.S.A. 17-7622(a).

147. K.S.A. 17-7616(d). See text at note 127, *supra*.

148. K.S.A. 17-7611(d) and (e) provide for cancellation of the articles of organization of an LLC that fails to maintain a resident agent. Subsection 17-7647(d) provides for forfeiture of the articles of organization of an LLC that fails to file its annual reports or pay its franchise taxes.

149. K.S.A. 17-7629.

150. K.S.A. 17-7608(a), -7622(b), -7623, -7634(a)(3). The Act's general filing and signature requirements are summarized in text at notes 18-21, *supra*.

151. K.S.A. 17-7624(b).

152. K.S.A. 17-7624(a).

153. K.S.A. 17-7624(c).

154. K.S.A. 17-7624(d).

155. K.S.A. 17-7625(a).

156. See K.S.A. 17-7607(a)(8).

157. K.S.A. 17-7625(b).



## Articles and Certificate of Dissolution

**Articles of Dissolution.** Upon completion of the winding up process, articles of dissolution must be executed by all members and filed with the secretary of state.<sup>158</sup> These articles must set forth the following facts: (a) the name of the LLC; (b) that a statement of intent to dissolve has been filed, and its filing date; (c) that all liabilities have been paid or discharged, or that adequate provision has been made for their payment or discharge; (d) that all remaining assets have been distributed among the members in accordance with their respective interests; and (e) that there are no suits pending against the LLC, or that adequate provision has been made for satisfaction of any adverse judgment in any pending suit.<sup>159</sup>

**Certificate of Dissolution.** If the articles of dissolution are in proper form, and if all required fees and franchise taxes have been paid, the secretary of state will file the articles and issue a certificate of dissolution to the representative of the dissolved LLC.<sup>160</sup> Upon issuance of the certificate of dissolution, the LLC's articles of organization are canceled and its existence ceases, except for purposes of litigation or administrative action.<sup>161</sup>

The managers in office at the time of dissolution, or if none, the members, thereafter serve in the capacity of trustees for the benefit of the members and creditors of the dissolved LLC. As such, the trustees have authority to distribute any property discovered after dissolution, to convey real estate, and to take any other necessary action on behalf of the dissolved LLC.<sup>162</sup>

## FOREIGN LIMITED LIABILITY COMPANIES

### Registration Requirements

Before doing business in Kansas, a foreign LLC must register with the secretary of state by filing an application for registration, executed by any member or manager, and paying the required filing fee.<sup>163</sup> The application, for which there is an official form, must set forth: (1) the name of the foreign LLC;<sup>164</sup> (2) its jurisdiction and date of organization, accompanied by a statement of good standing from that jurisdiction; (3) the type of business to be conducted in Kansas; (4) the address of its registered office in Kansas and the name and address of its resident agent for service of process;<sup>165</sup> (5) an irrevocable written consent that service of process may be made on the sec-

retary of state if the LLC fails to maintain a resident agent, if the agent cannot be found with reasonable diligence or if the LLC's registration is forfeited; (6) the name and address of all members, or, if the business is managed by managers, of all managers; and (7) the date on which the foreign LLC first did, or intends to do, business in the State of Kansas.<sup>166</sup>

After registration, a foreign LLC is, of course, free to transact business in Kansas. Subject to the Kansas constitution, the LLC's organization, internal affairs and the liability of its members will continue to be governed by the laws of the jurisdiction of its organization.<sup>167</sup>

A foreign LLC may cancel its registration by filing a certificate to that effect, executed by the members, with the secretary of state.<sup>168</sup> Cancellation of registration, however, will not terminate the secretary of state's authority to accept service of process on the foreign LLC with respect to causes of action arising from its having done business in Kansas.<sup>169</sup>

***Cancellation of registration, however, will not terminate the secretary of state's authority to accept service of process on the foreign LLC...***

### Penalty for Failure to Register

A foreign LLC doing business in Kansas may not sue in the Kansas courts until it has registered and has paid all fees and penalties for the period during which it did business in Kansas without having registered.<sup>170</sup> In addition, the attorney general may bring an action to enjoin an unregistered foreign LLC from doing business in Kansas.<sup>171</sup> However, failure to register will not: (1) impair the validity of any contract or other act of the foreign LLC; (2) impair the right of any other party to such a contract to maintain an action on the contract; or (3) prevent the foreign LLC from defending any action in a Kansas court.<sup>172</sup> Finally, and most importantly, a member of a foreign LLC

158. K.S.A. 17-7608(a), -7626, -7627(a), -7634(a)(3). The Act's general filing and signature requirements are summarized in text at notes 18-21, *supra*.

159. K.S.A. 17-7626.

160. K.S.A. 17-7627.

161. K.S.A. 17-7608(b), -7627(b), -7628.

162. K.S.A. 17-7627(b).

163. K.S.A. 17-7637.

164. The Act contains a requirement, similar to that applicable to domestic LLCs, that the name of a foreign LLC be such as to distinguish it from other business organizations on file in the office of the secretary of state. K.S.A. 17-7639(a).

165. As is the case with domestic LLCs, the registered office may but is not required to be a place of business. The resident agent may be an individual Kansas resident whose business office is the foreign LLC's registered office or may be a Kansas corporation. K.S.A. 17-7639(b).

166. K.S.A. 17-7637. If any statement in a registration application is false or inaccurate, either initially or due to a change in circumstances, a certificate correcting the statement, executed by a member, must promptly be filed with the secretary of state. K.S.A. 17-7640.

167. K.S.A. 17-7636(a).

168. K.S.A. 17-7641. In another apparent oversight, the Act does not specify precisely how many members must sign the certificate of cancellation. By its simple reference to "the members," section 17-7641 creates the possibility that all members must sign a certificate canceling registration, while any single member may sign and file an application for registration. A similar situation clearly exists regarding execution of analogous documents by members of domestic LLCs. See K.S.A. 17-7634(a)(1),(3).

169. K.S.A. 17-7641.

170. K.S.A. 17-7642(a).

171. K.S.A. 17-7643.

172. K.S.A. 17-7642(b).

is not personally liable for the foreign LLC's obligations merely because the LLC has done business in Kansas without having registered to do so.<sup>173</sup>

### ANNUAL REPORTS

As with their corporate and limited partnership counterparts,<sup>174</sup> every domestic LLC and every foreign LLC doing business in Kansas must file with the secretary of state an annual report of its financial condition as of the close of its tax year.<sup>175</sup> This annual report is due at the same time as the LLC's Kansas income tax return.<sup>176</sup> The report, which must be made on the prescribed official form, and which may be signed by any member, must set forth: (a) the name of the LLC; (b) a reconciliation of members' capital accounts, as reported on the LLC's federal income tax return; and (c) a balance sheet showing the LLC's financial condition as of the end of its tax year.<sup>177</sup> The report must be accompanied by the LLC's franchise tax, which is assessed in the amount of \$1 per \$1,000 of net capital accounts located or used in Kansas, but in no event less than \$20 or more than \$2,500.<sup>178</sup> Failure to file an annual report or pay the franchise tax may result in imposition of monetary penalties and forfeiture of the

LLC's articles of organization (if domestic) or authority to transact business in Kansas (if foreign).<sup>179</sup>

### CONCLUSION

As stated at the outset, the Act is now over three years old and has undergone two sets of amendments during that brief history. No doubt further technical amendments will be forthcoming. This is to be expected with any entirely new legislation, and it should not obscure the value of what has been accomplished to date.

The Act authorizes formation of a new type of business association, the LLC, that most often will be useful to those who wish to combine the limited liability of the corporate form with the flexibility, informality and flow-through taxation of the partnership form. Although lack of familiarity initially may be a drawback to the use of LLCs, this problem gradually will diminish with time. The Act's drafters, by frequently borrowing concepts and provisions from corporate and partnership law, have created a framework in which this familiarization process may be facilitated. Hopefully, this article will contribute to that process. ■

173. K.S.A. 17-7642(c).

174. See K.S.A. 17-7503, -7505, 56-1a606, -1a607.

175. K.S.A. 17-7647(a), -7648(a).

176. *Id.*

177. K.S.A. 17-7647(b),(c), -7648(b),(c).

178. K.S.A. 17-7647(c), -7648(c).

179. K.S.A. 17-7509, -7510, -7647(d), -7648(d).

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