

The Kansas Revised



Limited Liability Company Act

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T Introduction

The limited liability company (LLC) form of business organization has become a popular alternative to incorporation¹ because it offers participants limited liability for business obligations; broad flexibility with regard to ownership and management structure; and classification as a partnership for tax purposes, with resultant conduit treatment of items of income, gain, loss, deduction, or credit.² Kansas was the fourth state in the nation to adopt legislation authorizing LLCs when it enacted the Kansas Limited Liability Company Act (KLLCA) in 1990.³ During the period from 1991 through 1998, the legislature amended the KLLCA in every year except 1992.⁴ The result was a statute with a diverse ancestry, consisting principally of the Florida and Wyoming LLC statutes,⁵ the Uniform Partnership Act, the Uniform Limited Partnership Act, the Revised Uniform Limited Partnership Act, and various corporate sources.

In 1999, Kansas replaced the KLLCA with completely new legislation, the Kansas Revised Limited Liability Company Act (KRLCA),⁶ effective January 1, 2000.⁷ The KRLCA is patterned on the Delaware Limited Liability Company Act (DLLCA),⁸ thus continuing the parallelism in the business laws of the two states begun with their corporation codes. This article will provide an overview of the KRLCA, comparing and contrasting, where appropriate, the prior law under the KLLCA. It will consider the following general topics: organization; operation; organic changes; dissolution and winding up; and foreign LLCs.

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FOOTNOTES

1. For example, in 1999, 10,766 businesses filed documents of organization or qualification with the Kansas Secretary of State. Of these, 6,419 (60%) were corporations; 3,487 (32%) were LLCs; and 860 (8%) were limited partnerships. KANSAS SECRETARY OF STATE, BUSINESS SERVICES UPDATE (1999-2000).

2. Under the "check the box" regulations, effective January 1, 1997, an eligible domestic unincorporated business entity, such as an LLC, with two or more members will be classified as a partnership for federal tax purposes, unless the entity affirmatively elects to be classified as an association taxable as a corporation. I.R.C. § 7701(a)(2), (3); Treas. Reg. §§ 301.7701-2 to -3. If such an entity has only one owner, it simply is disregarded as an entity separate from its owner for federal tax purposes, again unless the entity affirmatively elects corporate tax status. Treas. Reg. § 301.7701-3. If, however, interests in an entity that otherwise would

be classified as a partnership are publicly traded, the entity will be classified as a corporation. I.R.C. §§ 7701(a)(2), (3), 7704; Treas. Reg. §§ 301.7701-2(b)(7), -3(a). Consequently, LLCs are most useful to closely-held business enterprises.

LLCs and their members have the same classification for Kansas tax purposes that they have for federal tax purposes. K.S.A. 1999 Supp. 17-76,138.

3. 1990 Kan. Sess. Laws, ch. 80. The KLLCA, as amended, was codified at K.S.A. 17-7601 to -7661 (1995 & 1998 Supp.) (repealed 2000).

4. See 1991 Kan. Sess. Laws, ch. 76; 1993 Kan. Sess. Laws, ch. 97; 1994 Kan. Sess. Laws, chs. 140, 182; 1995 Kan. Sess. Laws, ch. 245; 1996 Kan. Sess. Laws, ch. 135; 1997 Kan. Sess. Laws, chs. 55, 106; 1998 Kan. Sess. Laws, chs. 36, 121.

5. The current versions of these statutes are codified at FLA. STAT. ANN. §§ 608.401-703 (Supp. 2000); WYO. STAT. ANN. §§ 17-15-101 to -144 (1999).

6. 999 Kan. Sess. Laws, ch. 119, codified at K.S.A. 1999 Supp. 17-7662 to -7664.

7. K.S.A. 1999 Supp. 17-76,140.

8. DEL. CODE ANN. tit. 6, §§ 18-101 to -1109.

I. ORGANIZATION

A. General Requirements

1. Who May Form

Any person may form a Kansas LLC by executing and filing articles of organization with the Secretary of State.⁹ An LLC need only have one member,¹⁰ and there is no requirement that the person forming the LLC be a member. "Person," as used throughout the KRLCA, is broadly defined as a natural person, a partnership (general or limited, domestic or foreign), limited liability company (domestic or foreign), trust, estate, association, corporation, custodian, nominee, or any other individual or entity, either in its own or in a representative capacity.¹¹

2. Name

The name of an LLC must include the words "limited liability company" or "limited company" or the abbreviation or designation "LLC" or "LC."¹² Under prior law, if such a designator was not used, actively participating or knowingly acquiescing members were personally liable for any loss caused by the omission.¹³ This provision was out of step with the law governing other business organizations,¹⁴ and has been eliminated by the KRLCA.

An LLC's name also must be distinguishable from the names of other business entities organized or qualified to do business in Kansas. This requirement, however, may be waived in writing by the other business entity.¹⁵

Finally, the KRLCA explicitly validates a practice that is especially, but not exclusively, useful to professional LLCs by permitting a name to include the name of a member or manager.¹⁶ The statute also authorizes the use of "company," "association," "club," "foundation," "fund," "institute," "society," "union," "syndicate," "limited," "trust," or their abbreviations.¹⁷

3. Registered Office and Resident Agent

The KRLCA continues the requirement that each LLC maintain in Kansas a registered office (which need not be a place of its business) and a resident agent at that office.¹⁸ However, it liberalizes the class of persons who may serve as resident agent to include the following: an individual

Kansas resident; a Kansas corporation, limited partnership, limited liability company, or business trust; a foreign corporation, limited partnership, or limited liability company authorized to do business in Kansas; or the limited liability company itself.¹⁹

The KRLCA also replicates, with only minor stylistic changes, the KLLCA's provisions concerning a change of the registered office by the resident agent; resignation of the resident agent, with or without appointing a successor; and the death or move of a resident agent.²⁰ The only substantive change is the addition of a provision permitting a resident agent to change its name, as well as the registered office, by filing a certificate to that effect with the Secretary of State.²¹

4. Permitted Businesses or Activities

Under prior law there was some doubt whether an LLC could be organized on a nonprofit basis, or whether it could be organized to engage in nonbusiness activities.²² The KRLCA removes this doubt by clearly providing that an LLC "may carry on any lawful business, purpose or activity, whether or not for profit . . ."²³ Thus, for example, charitable organizations, unions, and social groups all are free to utilize the LLC form.

Banking and insurance are excepted from this broad authorization, as are any other businesses or activities "specifically prohibited by law."²⁴ Chief among the latter are the restrictions, and exceptions thereto, on ownership or leasing of agricultural land.²⁵

Finally, the KRLCA carries over, nearly verbatim, 1998 amendments to the KLLCA that were enacted to eliminate confusion about the ability of licensed professionals to practice in the LLC form.²⁶ These provisions make clear the ability of an LLC to exercise all powers exercisable by a professional association or corporation, including specifically the power to employ professionals to practice a profession, and subject to the restrictions applicable thereto.²⁷

5. Powers

The KRLCA replaces prior law's exhaustive list of specific LLC powers²⁸ with a general statement that an LLC has and may exercise all powers and privileges granted by the KRLCA, any other law, or its operating agreement, along with any incidental powers, insofar as necessary or convenient for its business, purposes, or activities.²⁹

9. K.S.A. 1999 Supp. 17-7673(a), -7676(a), -7678(a).

10. *Id.* 17-7663(f). The KLLCA introduced the concept of a one-member LLC in 1998, and this liberalization has been carried forward in the KRLCA. See 1998 Kan. Sess. Laws, ch. 36, § 1 (repealed 2000).

11. K.S.A. 1999 Supp. 17-7663(m).

12. *Id.* 17-7664(a).

13. K.S.A. 17-7606(b) (repealed 2000).

14. See K.S.A. 1999 Supp. 17-6002(a)(1), 56a-1002; K.S.A. 56-1a102.

15. K.S.A. 1999 Supp. 17-7664(c).

16. *Id.* 17-7664(b).

17. *Id.* 17-7664(d). The exclusive right to use a name may be reserved in the same way corporate names are reserved. *Id.* 17-7665.

18. *Id.* 17-7666(a).

19. *Id.* 17-7666(a)(2).

20. Compare *id.* 17-7666(b)-(e) with K.S.A. 17-7611(b)-(e) (repealed

2000).

21. K.S.A. 1999 Supp. 17-7666(b).

22. See K.S.A. 17-7603 (repealed 2000).

23. K.S.A. 1999 Supp. 17-7668(a).

24. *Id.*

25. See *id.* 17-5903 to -5904.

26. Compare *id.* 17-7668(c)-(h) with 1998 Kan. Sess. Laws, ch. 121, §§ 1-4 (repealed 2000). The concern stemmed from *Early Detection Center, Inc. v. Wilson*, 248 Kan. 869, 811 P.2d 860 (1991). But see *St. Francis Regional Medical Center, Inc. v. Weiss*, 254 Kan. 728, 869 P.2d 606 (1994) (distinguishing *Early Detection Center*).

27. K.S.A. 1999 Supp. 17-7668(c).

28. See 1998 Kan. Sess. Laws, ch. 121, § 6 (repealed 2000).

29. K.S.A. 1999 Supp. 17-7668(b).

6. General Filing and Signature Requirements

... any signature on a filed document may be a facsimile, a conformed, or an electronically transmitted signature.

The original signed copy and a duplicate copy (which may be either signed or conformed) of an LLC's articles of organization or any other certificate to be filed pursuant to the KRLCA 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 and return the duplicate to the person who filed it. Absent actual fraud, the Secretary of State's endorsement is conclusive evidence of the date and time of the document's filing.³⁰

Unless otherwise provided in an LLC's operating agreement, the operating agreement and any filed document may be signed by an attorney-in-fact or other agent, whose power of attorney or other authorization need not be in writing; need not be sworn to, verified or acknowledged; and need not be exhibited or filed with the document. A written power or authority, however, must be retained by the LLC.³¹ Moreover, any signature on a filed document may be a facsimile, a conformed, or an electronically transmitted signature.³² Although no filed document need be sworn to, execution constitutes an oath or affirmation under penalty of perjury that, to the best of the person's knowledge and belief, the facts stated in the document are true.³³

Any document may be filed by "telefacsimile communication," which is broadly defined as the use of electronic equipment to send or transfer a document.³⁴ Any document properly so filed is effective on its filing date.³⁵ The KRLCA eliminates the requirement of prior law that a telefacsimile filing be followed by an original paper filing within seven days,³⁶ a requirement that had become nothing more than a trap for the unwary.³⁷

B. Articles of Organization

1. Content

An LLC is formed by filing with the Secretary of State articles of organization, a document similar to a corporation's articles of incorporation or a limited partnership's certificate of limited partnership.³⁸ The required contents of the articles have been reduced to a bare minimum, consisting only of the following: (a) the LLC's name; (b) its resident agent and registered office; and (c) if the LLC is organized to engage in a licensed profession or professions, each such profession.³⁹ Thus, it is no longer necessary, as it was under prior law, to include a statement of when the LLC will dissolve; identification of its business or activities (unless it is a professional LLC); provisions regarding the admission of additional members; a statement regarding management structure; and a list of members or managers, as the case may be.⁴⁰

The prior law also expressly permitted the articles of organization to include:

any other provisions, not inconsistent with law, which the members elect to set out in the articles of organization for the regulation of . . . internal affairs . . . , including any provisions which . . . are required or permitted to be set out in the operating agreement⁴¹

Although the KRLCA does not specifically address inclusion in the articles of matters that otherwise would appear in the operating agreement, its permission to set forth in the articles "any other matters the members determine to include therein"⁴² certainly is broad enough to support that result.

2. Execution and Filing

The articles of organization may be signed by any "one or more authorized persons,"⁴³ with no requirement that the person be either a member or manager of the LLC. The articles must be filed with the Secretary of State, along with a filing fee of \$150.⁴⁴ The LLC will be considered formed

30. K.S.A. 1999 Supp. 17-7678(a). These filing provisions are substantively identical to prior law. See 1998 Kan. Sess. Laws, ch. 121, § 8 (repealed 2000).

31. K.S.A. 1999 Supp. 17-7676(b), -7678(a).

32. *Id.* 17-7678(a).

33. *Id.* 17-7676(c).

34. *Id.* 17-76,142.

35. *Id.* 17-76,142(a).

36. K.S.A. 17-7652(a) (repealed 2000).

37. Because facsimile and electronic signatures are validated, K.S.A. 1999 Supp. 17-7678(a), there is no longer any need for a paper filing. Subtle changes in the wording of corresponding provisions of the KLLCA and the KRLCA demonstrate how fully the latter embraces the electronic age. The KLLCA defined "telefacsimile communication" as "the use of electronic equipment to send or transfer a copy of an original document via telephone lines." K.S.A. 17-7652(b) (repealed 2000). The KRLCA alters the definition to read, "the use of electronic equipment to send or transfer a document." K.S.A. 1999 Supp. 17-76,142(b). See also 2000 Kan. Sess. Laws, ch. 120 (enacting the Uniform

Electronic Transactions Act).

38. K.S.A. 1999 Supp. 17-7673(a).

39. *Id.*

40. See 1998 Kan. Sess. Laws, ch. 121, § 7 (repealed 2000). But see K.S.A. 1999 Supp. 17-7693, discussed in text at notes 270-84, *infra*.

41. 1998 Kan. Sess. Laws, ch. 121, § 7 (repealed 2000).

42. K.S.A. 1999 Supp. 17-7673(a)(3).

43. *Id.* 17-7676(a). If a person who is required to execute a certificate fails or refuses to do so, any person who is adversely affected may petition the district court to direct execution. *Id.* 17-7677(a). Although this provision refers only to certificates and not also to articles of organization, as do other sections, there is no reason to believe that the absence of a specific reference to articles in section 17-7677(a) is the result of anything other than inadvertence. Compare *id.* 17-7676(a), (b), (c), -7678(a), (c). Note that the KRLCA was modeled after the DLLCA, but that the latter uses the terminology "certificate of formation" rather than "articles of organization." E.g., DEL. CODE ANN. tit. 6, §§ 18-101(2), -201(a).

44. K.S.A. 1999 Supp. 17-7673(a), -7678(a), -76,136(b).

and existing as a separate legal entity upon such filing or at any future effective date (which cannot be more than 90 days after the filing date) specified in the articles.⁴⁵ If the LLC is organized to exercise the powers of a professional association or corporation, it also must file with the Secretary of State a certificate from the appropriate licensing body that each member is licensed to practice the profession and that the LLC's name has been approved.⁴⁶

The KLLCA affirmatively prohibited an LLC from transacting any business, except business incidental to its organization or capitalization, prior to filing its articles of organization.⁴⁷ The penalty for violation of this prohibition was joint and several personal liability for the obligations of the business.⁴⁸ These provisions created the prospect that individual damage awards might be imposed on good faith, innocent members of a belatedly or defectively formed LLC in favor of third parties who never bargained for or relied on such liability when dealing with the LLC. They have wisely been eliminated by the KRLCA.

3. Notice

The fact that articles of organization are on file in the Secretary of State's office constitutes notice that the entity formed is an LLC, and also is notice of all matters stated in the articles that are *required* to be so stated.⁴⁹ Because the required contents of the articles have been reduced to minima, the primary importance of this provision is merely to charge the public with notice that the business is a limited liability enterprise.⁵⁰

4. Amendments, Corrections, and Restatements

An LLC's manager, or if there is no manager, then any member who becomes aware that any statement in the articles of organization was false when made or that any matter described has changed, making the articles inaccurate in any material respect, must promptly amend the articles.⁵¹ The articles may also be amended for any other proper purpose.⁵²

A certificate of amendment must be executed by an authorized person,⁵³ be filed with the Secretary of State,⁵⁴ and be accompanied by a fee of \$20.⁵⁵ Amendments are effective upon filing or as of a specified future effective date, which cannot be later than 90 days after their filing date.⁵⁶

An inaccuracy in the articles of organization also may be corrected by filing a certificate of correction.⁵⁷ A certificate of correction is subject to the same requirements as a certificate of amendment with respect to execution,⁵⁸ filing,⁵⁹ and fee.⁶⁰ Unlike a certificate of amendment, however, a certificate of correction is retroactively effective as of the original filing date of the articles or other certificate being corrected, except as to persons substantially and adversely affected by the correction.⁶¹

As another alternative, multiple errors, inaccuracies, and defects can be remedied by filing completely new and corrected articles of organization (or other certificate).⁶² Once again, corrected articles (or other certificate) must be executed by an authorized person⁶³ and filed with the Secretary of State.⁶⁴ Like a certificate of correction, a corrected certificate is retroactively effective as of the original filing date of the document being corrected, except as to persons who would be substantially and adversely affected.⁶⁵ In contrast to a certificate of correction, however, the filing fee for a corrected certificate is determined by the fee applicable to the document being corrected,⁶⁶ which in the case of articles of organization is \$150 rather than \$20.⁶⁷

If articles of organization have been amended several times, and retroactive correction is not called for, but integration into a single document is desired, the LLC may file restated articles of organization.⁶⁸ Restated articles may also further amend the articles of organization.⁶⁹ The above-described execution and filing requirements apply to

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45. *Id.* 17-7673(b).

46. *Id.* 17-7678(f). Professional LLCs organized under prior law were required to file a similar certificate along with their 1999 annual reports. *Id.* 17-7668(h).

47. K.S.A. 17-7609(b) (repealed 2000).

48. *Id.* 17-7621 (repealed 2000).

49. K.S.A. 1999 Supp. 17-7679.

50. *See id.* 17-7673(a). *But see id.* 17-7693, discussed in text at notes 270-84, *infra*.

51. K.S.A. 1999 Supp. 17-7674(b). A misplaced comma in the statutory text might cause one to believe that the materiality requirement applies only to statements that were originally correct but that have become incorrect due to a change in circumstances. This reading would require even immaterial inaccuracies to be corrected if they were inaccurate *ab initio*. This probably is not what the drafters intended. *Compare* K.S.A. 56-1a152(b) (duty to amend certificate of limited partnership).

Recall that an LLC's resident agent may change the resident agent's name, change the address of the LLC's registered office, or resign and appoint a successor resident agent all by filing with the Secretary of State a certificate stating the change. The filing of such a certificate by the resident agent is equivalent to amending the articles of

organization. K.S.A. 1999 Supp. 17-7666(b), (c). There is a \$20 filing fee. *Id.* 17-76,136(a)(1)(D).

52. K.S.A. 1999 Supp. 17-7674(c).

53. *Id.* 17-7676(a).

54. *Id.* 17-7674(a), -7678(a).

55. *Id.* 17-76,136(a)(1)(A).

56. *Id.* 17-7674(d), -7678(b).

57. *Id.* 17-7678(b), -7683(a).

58. *Id.* 17-7676(a).

59. *Id.* 17-7678(a), -7683(a).

60. *Id.* 17-76,136(a)(1)(F).

61. *Id.* 17-7683(a).

62. *Id.* 17-7683(b).

63. *Id.* 17-7676(a), -7683(b).

64. *Id.* 17-7678(a), -7683(b).

65. *Id.* 17-7683(b).

66. *Id.*

67. *Id.* 17-76,136(b).

68. *Id.* 17-7680(a).

69. *Id.*

restated articles.⁷⁰ The filing fee is \$20.⁷¹ Restated articles supersede the original articles and all previous amendments as of the filing date or future effective date of the restated articles.⁷² The original effective date of organization, however, remains unaffected.⁷³

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C. Operating Agreement

Unlike the articles of organization, an LLC's operating agreement is a private, internal document rather than a publicly-filed one. It is analogous to corporate by-laws or a limited partnership's partnership agreement. Like the latter, it has assumed ever greater significance as the required content of the organization's publicly-filed document has systematically been reduced by the legislature.

The KRLCA broadly defines "operating agreement" as "any agreement, written or oral, of the member or members as to the affairs of a limited liability company and the conduct of its business."⁷⁴ The requirement of prior law that an LLC have an operating agreement⁷⁵ has been eliminated, but it is clear that no LLC should fail to have one. The reason is that the KRLCA, continuing and extending the philosophy of its predecessor, is largely a set of default rules, subject to change by the operating agreement. It is this legislative philosophy that gives the LLC form one of its three most important features--flexibility. For example, the following matters may be affected by provisions in the operating agreement: business transactions of members and managers with the LLC;⁷⁶ indemnification;⁷⁷ approval of mergers, consolidations, and conversions;⁷⁸ appraisal rights;⁷⁹ assignment of LLC interests and admission of members;⁸⁰ classes, voting, and other rights of members and managers;⁸¹ the effect of bankruptcy on a person's status as

member;⁸² standards governing members' access to information;⁸³ management norms;⁸⁴ selection, admission, and termination of managers;⁸⁵ the status of a person who is both manager and member;⁸⁶ delegation of managerial powers;⁸⁷ liability for capital contributions;⁸⁸ allocation of profits, losses, and distributions;⁸⁹ rights and obligations regarding distributions;⁹⁰ and dissolution, winding up, and liquidation distributions.⁹¹

The operating agreement may be entered into before, concurrently with, or after the filing of the articles of organization. Regardless of when it is entered into, it may be made effective as of the time of formation of the LLC or at such other time as it may provide.⁹²

In order to facilitate admission of new members, the KRLCA permits a written operating agreement to provide that a person may be admitted as a member and become bound by the operating agreement without executing the agreement if the person or the person's representative complies with the conditions for membership and requests that the LLC's records reflect the admission.⁹³ Of course, a member may sign an operating agreement, either personally or by a representative,⁹⁴ but the statute affirmatively states that an operating agreement is not unenforceable by reason of it not having been signed.⁹⁵

The KRLCA further broadly states that its policy is to give maximum effect to freedom of contract and to the enforceability of operating agreements.⁹⁶ More specifically, it provides that to the extent a member, manager, or other person has duties and liabilities, including fiduciary duties, to the LLC or to another member or manager, such duties and liabilities may be expanded or restricted by the operating agreement.⁹⁷ Furthermore, any such member, manager, or other person acting under an operating agreement will not be liable for good faith reliance on the agreement.⁹⁸ Whether these provisions will be viewed as a *carte blanche* for outright contractual repeal of fiduciary duties remains to be seen.⁹⁹

70. *Id.* 17-7676(a), -7678(a), -7680(b).

71. *Id.* 17-76,136(a)(1)(B).

72. *Id.* 17-7680(d).

73. *Id.*

74. *Id.*

75. K.S.A. 17-7613 (repealed 2000).

76. K.S.A. 1999 Supp. 17-7669.

77. *Id.* 17-7670.

78. *Id.* 17-7681, -7685.

79. *Id.* 17-7682.

80. *Id.* 17-7686, -76,112, -76,114.

81. *Id.* 17-7687, -7695.

82. *Id.* 17-7689.

83. *Id.* 17-7690.

84. *Id.* 17-7693.

85. *Id.* 17-7663, -7692, -7693.

86. *Id.* 17-7694.

87. *Id.* 17-7698.

88. *Id.* 17-76,100.

89. *Id.* 17-76,101, -76,102.

90. *Id.* 17-76,104, -76,107 to -76,109.

91. *Id.* 17-76,116, -76,118, -76,119.

92. *Id.* 17-7673(c).

93. *Id.* 17-7663(g)(1)(B). Both the authorization of a representative to act for the new member and the request that membership be reflected on the LLC's records may be written, oral, or by some other action which may be nothing more than payment for an LLC interest. *Id.*

94. The member may authorize the representative in writing, orally,

or by some other action such as payment for an LLC interest. *Id.* 17-7663(g)(1)(A). If in writing, the representative's authority need not be sworn to, verified, or acknowledged, but must be retained by the LLC. *Id.* 17-7676(b).

95. *Id.* 17-7663(g)(2). Unlike subsection (g)(1), subsection (g)(2) is self-executing.

96. *Id.* 17-76,134(b). *Elf Atochem North America, Inc. v. Jaffari*, 727 A.2d 286 (Del. 1999), involved a substantially identical section of the DLLCA. There, a Delaware LLC's operating agreement provided that any disputes arising out of, under, or in connection with the operating agreement would be resolved exclusively by arbitration or judicial proceedings in California. The court held that this provision, coupled with the statutory policy favoring freedom of contract and the enforceability of operating agreements, required dismissal of a member's Delaware derivative suit alleging breach of fiduciary duty by the LLC's manager.

97. *Id.* 17-76,134(c)(2).

98. *Id.* 17-76,134(c)(1).

99. See 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 9.04 (1998). Given Kansas courts' traditionally strict view of fiduciary duties, an interpretation allowing total waiver seems unlikely, especially because the statute only speaks of restricting, not totally eliminating, fiduciary duties. *Cf.* K.S.A. 1999 Supp. 56a-103(b)(3)-(5) (partnership agreement may not eliminate duty of loyalty, unreasonably reduce duty of care, or eliminate obligation of good faith and fair dealing). Aside from the operating agreement, the extent and nature of fiduciary duties in an LLC is largely an undeveloped area. See text at notes 287-312, *infra*.

Jurisdiction over actions to interpret, apply, or enforce the operating agreement, or the duties, obligations, and liabilities of members, managers, and the LLC *inter se*, is vested in the district court.¹⁰⁰ The KRLCA also invites the operating agreement to include self-help penalties or consequences with respect to a member or manager who fails to comply with the agreement or at other times or upon the happening of other events specified in the agreement.¹⁰¹

D. Capital Contributions

1. Form and Necessity

A member's contribution to the capital of an LLC may take the form of cash, property, services rendered, or a promissory note or other obligation to contribute cash or property or to perform services in the future.¹⁰² This explicit validation of obligations to contribute cash or property or to perform services in the future represents a clarification, if not downright liberalization, of prior law that should be especially useful to asset-poor service members.¹⁰³ It also reconciles the LLC statute with that applicable to limited partnerships.¹⁰⁴ The KRLCA goes even farther, however, and provides that a person may become a member and may receive an LLC interest without making or even being obligated to make a contribution.¹⁰⁵ Thus, if the other members are willing to allocate a profits interest¹⁰⁶ to a service member who is unwilling to make a firm contractual commitment due to concern about possible future inability to perform, or any other reason, they may do so under the KRLCA.

2. Liability

If a member does become contractually committed to contribute cash or property or to perform services in the future, unless the operating agreement provides otherwise, the member will be obligated to fulfill that commitment even if he or she is unable to perform because of death, disability, or any other reason that might or might not otherwise excuse performance under general principles of contract law.¹⁰⁷ Moreover, usury will never be a defense.¹⁰⁸ A conditional obligation to make a contribution, however, including a contribution payable on a discretionary call, may not be enforced unless the condition has been satisfied or waived.¹⁰⁹

If a member fails to make a required contribution of services or property, the LLC has the option of requiring the member to contribute cash equal to the amount of the agreed value of the contribution that has not been made. This cash option is expressly stated to be in addition to, and not in lieu of, other remedies, such as specific performance, that may be available to the LLC in a particular case.¹¹⁰ It will be most useful in cases in which a member fails to perform promised services for reasons that otherwise would excuse performance under general contract law.

In addition to judicial enforcement, the KRLCA specifically authorizes an LLC's operating agreement to impose penalties or consequences on a member who defaults on an obligation to make a capital contribution. These penalties or consequences include, but are not limited to, the following: reducing or eliminating the member's interest in the LLC; subordinating the member's interest to those of nondefaulting members; forced sale of the member's interest; forfeiture of the member's interest; lending by other members of the amount necessary to meet the commitment; or valuation of the interest by formula or appraisal followed by sale or redemption of the interest.¹¹¹

Unless the operating agreement provides otherwise, a member's obligation to make a contribution may be compromised or waived only by unanimous consent of the other members.¹¹² Even if the other members have waived or compromised the obligation, a creditor who extended credit to the LLC during any period the obligation was reflected in the operating agreement may enforce the original obligation to the extent that the creditor reasonably relied on the obligation in extending credit.¹¹³

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100. K.S.A. 1999 Supp. 17-7672. In *Elf Atochem North America, Inc. v. Jaffari*, 727 A.2d 286 (Del. 1999), the court held that a substantially identical statutory provision could be overridden, and the court divested of subject matter jurisdiction, by a provision to that effect in an LLC's operating agreement viewed in light of the statutory policy of freedom of contract and the enforceability of operating agreements.

101. *Id.* 17-7691, -7696. In addition to these general provisions, the KRLCA speaks more specifically to penalties and consequences that the operating agreement may provide for a member who fails to make a required capital contribution. See *id.* 17-76,100(c), discussed in text at note 111, *infra*.

102. K.S.A. 1999 Supp. 17-7663(c), -7699.

103. See K.S.A. 17-7602(i) (repealed 2000).

104. See K.S.A. 56-1a101(b), -1a301.

105. K.S.A. 1999 Supp. 17-7686(c). This same subsection permits a

person to become a member without even acquiring an LLC interest. See note 136, *infra*.

106. K.S.A. 1999 Supp. 17-7663(h) defines an LLC interest as a member's share of profits and losses and right to receive distributions of assets.

107. *Id.* 17-76,100(a).

108. *Id.* 17-76,103.

109. *Id.* 17-76,100(b).

110. *Id.* 17-76,100(a).

111. *Id.* 17-76,100(c).

112. *Id.* 17-76,100(b). This unanimous consent requirement is greater than the normal default voting rule under the KRLCA, which is a majority of the profits interest. *Id.* 17-7663(j), -7687(d), -7693(a). See text at notes 149-50, *infra*.

113. K.S.A. 1999 Supp. 17-76,100(b).

E. LLC Interests as "Securities"

1. Federal Law

A detailed discussion of the impact of the federal and state securities laws on the organization of an LLC is beyond the scope of this article. A brief examination of

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when an interest in an LLC is a "security" within the meaning of those laws, however, may be in order.

The Securities Act of 1933 and the Securities Exchange Act of 1934 contain similar definitions of the term "security." Neither lists LLC interests, but both refer to several open-ended terms, including "investment contract."¹¹⁴ Although there is a dearth of case law directly on point, most would agree that the issue is whether a particular LLC interest is an investment contract.¹¹⁵ At present, this question is best resolved by analogizing to the treatment of partnership interests, which also are not specifically included in the definition of "security," but as to which there is a somewhat better developed body of case law.¹¹⁶

In *SEC v. W.J. Howey Co.*,¹¹⁷ the Supreme Court held that an "investment contract" involved an investment of money; in a common enterprise; with the expectation of deriving profits; solely from the efforts of the promoter or a third party.¹¹⁸ As refined by subsequent opinions, this test may be restated as whether there is "an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."¹¹⁹

In the present context, the primary issue is whether a partner or a member of an LLC expects to derive profits principally from the entrepreneurial or managerial efforts of others, or at least in significant part, from the partner's or member's own efforts. Because the norms of partnership law make each partner an agent of the business, afford each partner access to important information about the business, and give each partner the right to participate in management,¹²⁰ the presumption is that partners in a general partnership are active entrepreneurs rather than passive investors, and that their interests in the partnership therefore are not securities.

The leading case of *Williamson v. Tucker*,¹²¹ however,

recognized that there may be exceptions to this proposition, in which a general partner is in law or in fact merely a passive investor. The *Williamson* court gave three examples, as follows: (1) the partnership agreement delegated controlling power to a managing partner or partners and left so little power in the hands of the other partners that it distributed power as would a prototypical limited partnership; (2) a particular partner was so inexperienced or unknowledgeable in business affairs that he or she, in fact, was incapable of exercising a partner's powers; or (3) the manager had such unique entrepreneurial or managerial abilities that the other partners could not replace the manager or otherwise exercise meaningful partnership powers.¹²²

The controlling case in the Tenth Circuit is *Banghart v. Hollywood General Partnership*,¹²³ in which the court took note of *Williamson*, but held that the provisions of the partnership agreement must be the primary focus. If the agreement allocates to the partners specific and unambiguous powers that afford them access to information and the ability to protect their investments, then their interests in the partnership are presumed not to be investment contracts. This presumption is strong and can only be overcome by evidence that the partners were rendered passive because they were precluded somehow from exercising their retained powers.¹²⁴ Thus, there must be evidence either that the partnership agreement did not afford customary powers to the partners, or if it did, that they were somehow prevented from exercising those powers. *Banghart* does not specify how partners might be precluded from exercising their powers. The opinion does indicate, however, that neither mere passivity in fact nor lack of business knowledge and experience will be legally sufficient to establish such preclusion.¹²⁵

As will be discussed below, an LLC may be managed by its members or by a manager or managers.¹²⁶ If the *Banghart* analysis applies, interests in a member-managed LLC will not be investment contracts, and hence not securities, unless the members are prevented from exercising their managerial powers in some as yet unspecified way. If, however, the operating agreement calls for one or more managers, it cannot automatically be concluded that the interests of the nonmanaging members necessarily are investment contracts. This is so because the allocation of rights, powers and obligations between managers and members is subject to wide variation, depending on the operating agreement and the default provisions of the KRLCA.¹²⁷ Nevertheless, because *Banghart* provides so lit-

114. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (Supp. 1998).

115. *Keith v. Black Diamond Advisors, Inc.*, [1999 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 90,458 (S.D.N.Y. March 8, 1999).

116. See *id.* for a clear example of this approach to LLC interests.

117. 328 U.S. 293 (1946).

118. *Id.* at 298-99, 301.

119. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975); see *Maritan v. Birmingham Properties*, 875 F.2d 1451, 1456 (10th Cir. 1989). This restatement softens *Howey*'s requirement that profits come "solely" from the efforts of others.

120. K.S.A. 1999 Supp. 56a-301(a), -401(f), (j), -403.

121. 645 F.2d 404 (5th Cir.), cert. denied, 454 U.S. 897 (1981).

122. *Id.* at 424 & n.15.

123. 902 F.2d 805 (10th Cir. 1990).

124. *Id.* at 807-08.

125. *Id.* at 808 & n.5.

126. K.S.A. 1999 Supp. 17-7693. See text at notes 242-52 & 261-84, *infra*.

127. E.g., K.S.A. 1999 Supp. 17-7693(a): "[I]f an operating agreement provides for the management, in whole or in part, of a limited liability company by a manager, the management of the limited liability company, to the extent so provided, shall be vested in the manager ...". There was no evidence of the terms of the partnership agreement in *Banghart*, but the two cases it relied on as authority both involved partnerships with managing partners. The nonmanaging partners, however, retained sufficiently important residual powers that the courts were able to conclude their partnership interests failed to satisfy the final element in the definition of an investment contract. See *Matek v. Murat*, 862 F.2d 720, 731-32 (9th Cir. 1988); *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 241-42 (4th Cir. 1988).

tle in the way of concrete guidance, a conservative posture may call for the assumption that interests in manager-managed LLCs are securities.

2. Kansas Law

The Kansas Securities Act definition of "security" mirrors its federal counterparts, including "investment contract," while omitting any direct reference to interests in LLCs or partnerships.¹²⁸ Kansas case law likewise has adopted the refined *Howey* analysis of an investment contract.¹²⁹

Absent controlling authority specifically governing interests in LLCs, once again the most appropriate approach is to analogize to general partnership interests. There is one reported decision dealing with the question whether a general partner's interest is an investment contract under Kansas law, *State v. Ribadeneira*.¹³⁰ Unfortunately, the facts as reported are less than clear. It appears that the defendant organized a limited partnership in which limited partner interests were marketed pursuant to an offering memorandum stressing that defendant would have full control over management of partnership operations, and that the limited partners must rely solely on defendant's ability to manage the business. The defendant actually was only one of several general partners, however. After the business failed, one of the other general partners claimed that the defendant had violated the Kansas Securities Act in selling the plaintiff his general partner interest. The question thus was squarely presented whether the general partner interest at issue was an investment contract, and therefore a security, under Kansas law.

The court began its analysis by noting that limited partner interests, by reason of the limited partners' passivity, are always securities, but that general partner interests are not. A true general partner relies on his or her own managerial efforts rather than those of others. The court noted, however, that the economic realities of the situation, rather than labels, must control. If the efforts of persons other than the investor are the undeniably significant managerial efforts, the interest is a security despite it being labeled a general partner interest. Stating that this was a question of fact, the court ultimately affirmed the jury finding that the interest was a security, on the basis that the finding was supported by substantial competent evidence.¹³¹

The court declined to review the evidence in detail, but noted some of the other general partners testified that the defendant exercised all managerial authority. The court also quoted the offering memorandum used to market the limited partner interests, which stressed reliance on the defendant's efforts, and concluded that it applied with equal force to the general partners other than the defendant. In short, the court equated the position of the other general

partners with that of the limited partners--the ultimate success or failure of the enterprise rested on the defendant's managerial and entrepreneurial skills.¹³²

It is unfortunate that the court did not indicate more specifically why this was so. Did the partnership agreement vest sole managerial authority in the defendant? If not, were the other general partners so inexperienced and unknowledgeable that they were forced, in fact, to rely on the defendant even though they technically may have possessed meaningful partners' powers? Did the defendant possess unique and irreplaceable managerial abilities?¹³³ Did the other general partners simply choose to remain passive and thus informally delegate managerial power to the defendant? Lacking these facts, it is difficult to predict the circumstances under which general partner interests will or will not be considered investment contracts, and thus securities, under Kansas law.

If *Ribadeneira* is applied to Kansas LLCs, it is probable that vesting general management powers in managers will cause the nonmanaging members' interests to be investment contracts. If the LLC is to be managed by the members, it is still possible that the interests of some members will be investment contracts if, in fact, those members are passive investors. No definite conclusion can be reached on this point because the terms of the partnership agreement are not reported in *Ribadeneira*.

A true general partner relies on his or her own managerial efforts rather than those of others.

II. OPERATION

A. Members

1. Rights in General

As a general proposition, a member of an LLC is a person¹³⁴ who has been admitted to the LLC in accordance with the KRLCA and the operating agreement, and whose admission is reflected in the LLC's records.¹³⁵ There is no requirement that a member acquire an economic interest in the LLC.¹³⁶

With very few exceptions, the KRLCA does not attempt to delineate in detail the rights of members. Rather, in keeping with its philosophy of freedom of contract,¹³⁷ it delegates these matters to the operating agreement. In an advance over prior law, the KRLCA expressly authorizes the operating agreement to provide for different classes or

128. See K.S.A. 1999 Supp. 17-1252(j).

129. See *Activator Supply Co. v. Wurth*, 239 Kan. 610, 722 P.2d 1081 (1986); *State ex rel. Owens v. Colby*, 231 Kan. 498, 646 P.2d 1071 (1982).

130. 15 Kan. App. 2d 734, 817 P.2d 1105, rev. denied, 249 Kan. 778 (1991).

131. *Id.* at 739-41, 817 P.2d at 1110-11.

132. *Id.*

133. See *Williamson v. Tucker*, 645 F.2d 404 (5th Cir.), cert. denied, 454 U.S. 897 (1981), discussed in text at notes 121-22, *supra*.

134. See K.S.A. 1999 Supp. 17-7663(m).

135. *Id.* 17-7663(l), -7686.

136. *Id.* 17-7686(c). This provision is necessary because the KRLCA authorizes creation of nonprofit LLCs. See *id.* 17-7668(a). It also may be useful for LLCs engaged in profit-seeking businesses. For example, an LLC that owns a farm being farmed by a tenant farmer might qualify as a limited liability agricultural company or a family farm limited liability agricultural company by making the tenant farmer a member without an economic interest as such in the LLC. See *id.* 17-5903(u)(3), (w)(3).

137. *Id.* 17-76,134(b).

groups of members with differing rights, powers, and duties.¹³⁸ An operating agreement may also authorize the creation in the future of additional classes or groups of

members with rights senior to those of existing members.¹³⁹ If the operating agreement so provides, such action could even be taken without the vote or prior approval of any member or class or group of members.¹⁴⁰

An LLC's operating agreement may grant the right to vote on any matter to all members, to certain identified members, or to specified classes or groups of members.

2. Meetings

In contrast to prior law, which contained apparently mandatory provisions regarding regular and special meetings of members,¹⁴¹ the approach of the KRLCA is permissive. It contemplates that members may hold meetings, but it does not require them.¹⁴² If meetings are to be held, the operating agreement may contain provisions relating to record date, notice, waiver of notice, quorum, proxy voting, and any other matters regarding meetings and voting.¹⁴³ The statute permits the use of proxies unless the operating agreement provides otherwise,¹⁴⁴ and provides that a written

and signed waiver of notice is deemed the equivalent of notice.¹⁴⁵

3. Voting

An LLC's operating agreement may grant the right to vote on any matter to all members, to certain identified members, or to specified classes or groups of members.¹⁴⁶ Conversely, an operating agreement may provide that any member or any class or group of members will not have voting rights.¹⁴⁷ If granted, the right to vote may be made exercisable by the membership as a whole, or separately on a class or group basis. Voting may be per capita, by financial interest (either in profits or in capital), or on any other basis.¹⁴⁸

If the operating agreement is silent, and no other provi-

sion of the KRLCA provides otherwise, voting is by profits interest, and every member holding an interest in profits is entitled to vote.¹⁴⁹ The vote necessary for most actions is a majority of the then current profits interests, unless there are different classes or groups of members, in which case the required vote is a majority of the profits interests in each class or group.¹⁵⁰ This general default rule stands in marked contrast to prior law, which provided for per capita voting.¹⁵¹ It applies not only generally to management decisions in a member-managed LLC,¹⁵² but also specifically to approval of a merger or consolidation,¹⁵³ approval of conversion of an LLC into another form of unincorporated business organization,¹⁵⁴ approval of dissolution,¹⁵⁵ or selection of a person to wind up an LLC's business in cases in which there is no manager.¹⁵⁶

As to certain matters, however, the KRLCA provides for a different default vote. Thus, unless otherwise provided in the operating agreement, admission of new members after formation of the LLC requires unanimous approval.¹⁵⁷ A similar default rule applies to the waiver or compromise of a member's obligation to make a capital contribution.¹⁵⁸ On the other hand, unless either the articles of organization or the operating agreement provide otherwise, a transaction that is not in the ordinary course of business must be approved by a majority *in number* of the members.¹⁵⁹

There also are certain important matters as to which the KRLCA arguably may not provide a default voting requirement.¹⁶⁰ If an LLC is to be managed by managers, some provision must be made for their manner and frequency of selection. The KRLCA merely states that managers are to be chosen by the members in the manner provided in the operating agreement.¹⁶¹ The original 1990 version of the KLLCA envisioned an LLC's managers as similar to a corporation's board of directors, and mandated annual election by the members.¹⁶² This mode of operation is still permissible, although not required, and leaves the greatest amount of control with the members consistent with centralized management. If desired, the vote necessary for election, e.g., by a plurality, should be specified in the operating agreement.¹⁶³ At the other end of the spectrum is an LLC whose managers are named in the operating agreement and who are intended to serve until death, resignation, or removal for cause.¹⁶⁴ Even then, the vote necessary for removal and for the filling of any vacancies should be

138. *Id.* 17-7687(a). Compare K.S.A. 17-7613 (repealed 2000).

139. K.S.A. 1999 Supp. 17-7687(a).

140. *Id.*

141. See K.S.A. 17-7613 (repealed 2000).

142. See K.S.A. 1999 Supp. 17-7687(c).

143. *Id.*

144. *Id.* 17-7687(d).

145. *Id.* 17-7687(f).

146. *Id.* 17-7687(b).

147. *Id.* 17-7687(a).

148. *Id.* 17-7687(b).

149. *Id.* 17-7687(e), -7693(a).

150. *Id.* 17-7663(j), -7687(d), -7693(a). Although there is some lack of uniformity in the statutory language with respect to class voting, the interpretation stated in the text is believed to most accurately reflect the drafters' intent.

151. K.S.A. 17-7612 (repealed 2000).

152. K.S.A. 1999 Supp. 17-7693(a).

153. *Id.* 17-7663(j), -7681(a).

154. *Id.* 17-7663(j), -7685.

155. *Id.* 17-76,116(a)(3), (b).

156. *Id.* 17-76,118(a).

157. *Id.* 17-7686(b)(1), (2), -76,112(a), -76,114(a).

158. *Id.* 17-76,100(b).

159. *Id.* 17-7693(c). This default voting requirement may be an inadvertent carryover from prior law. See K.S.A. 17-7614(d) (repealed 2000).

160. The default voting provisions in K.S.A. 1999 Supp. 17-7693(a) in terms apply only to management of a member-managed LLC. The language with reference to voting in *id.* 17-7687(d) is not so circumscribed, but is stated in a rather offhand manner in a sentence that is devoted primarily to action by written consent. Although literally broad enough to constitute a universal default voting rule, its placement is not where one would expect to find such a rule.

161. *Id.* 17-7693(a).

162. 1990 Kan. Sess. Laws, ch. 80, § 12 (repealed 1991).

163. See K.S.A. 17-6506(c) (corporate directors elected by plurality vote).

164. See K.S.A. 1999 Supp. 17-7663(k), -7692.

addressed in the operating agreement.

The KRLCA also may fail to provide a default voting requirement for amendment of either the articles of organization or the operating agreement.¹⁶⁵ To eliminate uncertainty, each of these two governing documents should include some provision controlling its amendment. In the case of the operating agreement, this provision could even permit amendment by managers, without the vote or approval of the members or any class or group of members.¹⁶⁶ Absent some provision speaking to amendment, however, there is a possibility that a court might require a unanimous vote of the members.¹⁶⁷

An LLC's operating agreement also may provide for action by written consent in lieu of a meeting.¹⁶⁸ In fact, unless the agreement provides otherwise, members may act by written consent with respect to any matter upon which they otherwise might vote.¹⁶⁹ The consent or consents must be signed by members having not less than the minimum number of votes that would be necessary to take the particular action at a meeting. Unless the KRLCA or the operating agreement provides otherwise, this number is a majority of the profits interests of each class entitled to vote on the matter.¹⁷⁰ This is a relaxation of the prior law's requirement of unanimity,¹⁷¹ and also is more liberal than current corporate law, which requires unanimous consent for shareholder action.¹⁷²

Any member has standing to challenge, and the district court has jurisdiction to determine, the validity of any admission, election, appointment, removal, or resignation of a manager of an LLC.¹⁷³ Similar provision is made for resolution of disputes concerning any other matter as to which members have the right to vote.¹⁷⁴

4. Right to Information

The KRLCA essentially replicates prior law regarding a member's right to demand and receive relevant information from the LLC for any purpose reasonably related to the member's interest as a member.¹⁷⁵ The only significant difference in the type of information and records covered is the addition of the operating agreement.¹⁷⁶

Several other innovations also have been added. The first of these permits a manager to keep confidential from the members, for as long as the manager deems reasonable,

information the manager reasonably believes to be in the nature of trade secrets or other information the disclosure of which the manager in good faith believes could damage the LLC or its business, which is not in the best interest of the LLC, or which the LLC is required by law or agreement to keep confidential.¹⁷⁷ Second, LLCs are authorized to keep their records in other than written form, e.g., electronically, if the records can be converted to written form within a reasonable time.¹⁷⁸ Finally, the KRLCA establishes a summary procedure by which the district court may resolve disputes concerning the production of lists of members and managers.¹⁷⁹

5. Liability

As a general proposition, the KRLCA provides that an LLC's debts, obligations, and liabilities, whether in contract, tort, or otherwise, are solely those of the LLC. No member or manager is personally obligated for the LLC's debts, obligations, or liabilities solely by reason of being a member or acting as a manager.¹⁸⁰ This substantive rule is reinforced 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 purpose is to enforce a member's or manager's rights against or liability to the LLC.¹⁸¹

This insulation from individual liability for enterprise obligations is analogous to that of a corporate shareholder and is one of the most attractive features of the LLC form. Nevertheless, members must keep in mind that while they will not be liable for the LLC's obligations *solely* because they are members, they will continue to be liable for their own obligations, even if those obligations are also those of the LLC. Thus, a member who co-signs or guarantees an LLC obligation will be liable as a co-obligor or guarantor.¹⁸² Similarly, a member who commits a tort will be primarily liable as the tortfeasor, whether or not the LLC is also vicariously liable under the doctrine of *respondeat superior*.¹⁸³

Although two statutory bases for personal liability that existed under prior law have been eliminated by the KRLCA,¹⁸⁴ corporate common law is the source of another

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165. See note 160, *supra*.

166. K.S.A. 1999 Supp. 17-7687(a).

167. *Cf. id.* 56a-103, -401(j) (unless otherwise agreed, partnership agreement may be amended only with consent of all partners).

168. *Id.* 17-7687(c).

169. *Id.* 17-7687(d).

170. *Id.* 17-7663(j), -7687(d).

171. See K.S.A. 17-7613 (repealed 2000).

172. *Id.* 17-6518.

173. K.S.A. 1999 Supp. 17-7671(a).

174. *Id.* 17-7671(b).

175. Compare *id.* 17-7690(a) with K.S.A. 17-7653(a) (repealed 2000). Both statutes lighten the record-keeping obligation by providing that failure to maintain books and records is not a ground for imposition of personal liability on any member or manager. K.S.A. 1999 Supp. 17-7690(g); K.S.A. 17-7653(b) (repealed 2000). Under the KRLCA, a demand must be in writing and must state its purpose. K.S.A. 1999 Supp. 17-7690(e).

176. K.S.A. 1999 Supp. 17-7690(a)(4).

177. *Id.* 17-7690(c).

178. *Id.* 17-7690(d).

179. *Id.* 17-7690(f).

180. *Id.* 17-7688(a).

181. *Id.* 17-7688(c).

182. *Id.* 17-7688(b) provides that notwithstanding the general rule of limited liability, a member or manager may agree to be personally obligated for any or all of the LLC's debts, obligations, and liabilities.

183. *Cf. Kerns v. G.A.C., Inc.*, 255 Kan. 264, 273-75, 875 P.2d 949, 957-58 (1994) (directors, officers, agents, and employees of corporation individually liable for torts they commit or in which they participate).

184. K.S.A. 17-7606(b) (repealed 2000) provided that omission of the words "limited company" or "limited liability company" or the abbreviations or designations "L.C." or "LC" or "L.L.C." or "LLC" in use of an LLC's name would make members who actively participated or knowingly acquiesced in the omission personally liable for any indebtedness, damage, or liability caused by the omission. *Id.* 17-7621 (repealed 2000) provided that all persons who assumed to act as an LLC without authority to do so would be jointly and severally liable for all debts and liabilities. Neither of these provisions has a counterpart in the KRLCA.

potential threat to the limited liability of members of an LLC. Under the doctrine known as "piercing the corporate veil," a court may disregard the separate entity of a corporation if a shareholder's relationship

... "Failure to maintain books and records shall not be grounds for personal liability of any member or manager."

with the corporation is so intimate, control so dominating, and the business and assets of the two so mingled, that recognition of the corporation's separate existence would result in fraud or injustice to third parties.¹⁸⁵

There is a substantial likelihood that this judicial exception to the limited liability of corporate shareholders will be similarly engrafted onto the limited liability of members of an LLC. After all, merely changing the form of an artificial entity from corporation to LLC in no way changes the potential for abuse of the separate entity concept by unscrupulous operators, nor should

it circumscribe the traditional equity jurisdiction of the judiciary.¹⁸⁶

Assuming the Kansas courts would be willing to disregard the separate entity of an LLC in an appropriate case, the decision in *Kvassay v. Murray*¹⁸⁷ provides a useful catalogue of factors considered in corporate cases, as follows: (a) undercapitalization; (b) failure to observe corporate formalities; (c) nonpayment of dividends; (d) siphoning of funds by the dominant shareholder; (e) nonfunctioning of other officers and directors; (f) absence of corporate records; (g) use of the corporation as a facade for operations of dominant shareholders; and (h) use of the entity to promote fraud or injustice.¹⁸⁸ While many of these factors are readily applicable to LLCs by analogy, some, such as nonpayment of dividends, are not. Two deserve special mention.

The first is failure to observe corporate formalities. The failure of corporate shareholders to conduct their internal affairs in the ritualistic corporate manner is important not so much because it prejudices creditors and other third parties, as some of the other factors do, but because it makes it easier for a court to disregard a corporate entity if the shareholders themselves, by their own actions, already have done so. An LLC, however, is not required to conduct

its internal affairs with the same formality required of corporations. Therefore, this factor should be entitled to little, if any, weight in a decision whether to pierce an LLC's veil.¹⁸⁹

A separate but related factor is the absence of corporate records, such as financial statements, tax returns, and annual reports. This factor is significant not only because it indicates a lack of separateness between a business entity and its owner in the mind of the owner, but also because the absence of adequate and accurate books and records may be prejudicial to outsiders who deal with the business. In addition, the importance of such records is not peculiar to corporations.¹⁹⁰ As such, this factor should be equally applicable in piercing cases involving LLCs. Unfortunately, the matter is complicated by a provision in the KRLCA, carried over from prior law, that states: "Failure to maintain books and records shall not be grounds for personal liability of any member or manager."¹⁹¹ Because this provision is part of a section that grants information rights to members and managers,¹⁹² it is probable that the insulation from liability was meant to apply only to liability to other members or managers flowing from nonproduction of books and records. Nevertheless, the language is unlimited and might be read to eliminate this factor in piercing cases.

6. Admission of New Members

After the formation of an LLC, a person who is not an assignee of an outstanding LLC interest¹⁹³ may be admitted as a member at the time provided in and upon compliance with the operating agreement. If the operating agreement is silent, the person will be admitted only if all members consent and when the admission is reflected in the LLC's records.¹⁹⁴ A person may be admitted as a member and may receive an LLC interest without making or being obligated to make a capital contribution to the LLC.¹⁹⁵ Unless the operating agreement provides otherwise, a person also may become a member without acquiring an LLC interest.¹⁹⁶ Finally, a written operating agreement may provide that a person may be admitted as a member without signing the agreement if the person complies with the conditions for becoming a member and requests that the LLC's records reflect the admission.¹⁹⁷

185. *Dean Operations, Inc. v. One Seventy Associates*, 257 Kan. 676, 896 P.2d 1012 (1995); *Golconda Screw, Inc. v. West Bottoms Ltd.*, 20 Kan. App. 2d 1002, 894 P.2d 260 (1995); *Kvassay v. Murray*, 15 Kan. App. 2d 426, 808 P.2d 896, *rev. denied*, 248 Kan. 996 (1991).

186. A number of state LLC statutes expressly extend the veil piercing doctrine to LLCs. See, e.g., CAL. CORP. CODE ANN. § 17101(b) (West Supp. 2000); COLO. REV. STAT. ANN. § 7-80-107(1) (1999); GA. CODE ANN. § 14-11-314 (1994); ME. REV. STAT. ANN. tit. 31, § 645(3) (West Supp. 1999); WASH. REV. CODE ANN. § 25.15.060 (West Supp. 2000). See generally Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1 (1997), discussing various state LLC statutes and concluding that courts are likely to pierce the veil of an LLC in an appropriate case regardless of differences in the wording of individual statutes.

187. 15 Kan. App. 2d 426, 808 P.2d 896, *rev. denied*, 248 Kan. 996 (1991).

188. *Id.* at 437-40, 808 P.2d at 904-06.

189. A number of statutes adopted in other states expressly exclude failure to observe formalities from consideration in LLC piercing cases.

See, e.g., CAL. CORP. CODE ANN. § 17101(b) (West Supp. 2000); COLO. REV. STAT. ANN. § 7-80-107(2) (1999); GA. CODE ANN. § 14-11-314 (1994); TENN. CODE ANN. § 48-217-101(e) (1995); WASH. REV. CODE ANN. § 25.15.060 (West Supp. 2000); W. VA. CODE § 31B-3-303(b) (1996).

190. Compare K.S.A. 1999 Supp. 17-7503, -7505 with *id.* 17-76,139 (annual reports).

191. *Id.* 17-7690(g).

192. *Id.* 17-7690, discussed in text at notes 175-79, *supra*.

193. Admission of assignees of LLC interests as members is discussed in the text at notes 202-09, *infra*.

194. K.S.A. 1999 Supp. 17-7686(b)(1). Unless otherwise provided in the agreement of merger or consolidation, a person who acquires an interest in the LLC surviving or resulting from a merger or consolidation is admitted as a member of the surviving or resulting LLC at the time provided in and upon compliance with its operating agreement. *Id.* 17-7686(b)(3).

195. *Id.* 17-7686(c).

196. *Id.*

197. *Id.* 17-7663(g)(1)(B). See note 93 & accompanying text, *supra*.

7. Transfers of Members' Interests

An interest in an LLC is personal property, consisting of a member's share of profits and losses and right to receive distributions of LLC assets.¹⁹⁸ It may be evidenced by a certificate if the operating agreement so provides.¹⁹⁹

As personal property, an LLC interest is transferable in whole or in part, except as provided in the operating agreement.²⁰⁰ Nevertheless, it also is clear under the KRLCA that an operating agreement may absolutely prohibit transfers or assignments even though such a prohibition might not otherwise be valid under applicable law.²⁰¹

Assuming that assignments are not prohibited, an assignee of an LLC interest is not entitled to become a member or to exercise any management or other rights and powers of a member except as provided in the operating agreement and in compliance with the agreement. If the operating agreement is silent, the approval of all members other than the assignor is necessary.²⁰² Thus, unless otherwise provided in the operating agreement, a simple assignment merely entitles the assignee to economic rights, i.e., the right, to the extent of the assignment, to share in the profits and losses, to receive the distributions, and to receive the allocations of income, gain, loss, deduction, or credit to which the assignor would have been entitled.²⁰³ Correspondingly, unless otherwise provided in the operating agreement, a simple assignee has no liability as a member solely by reason of the assignment.²⁰⁴

As noted above, an assignee of an LLC interest may become a member as provided in, and upon compliance with, the operating agreement, or alternatively, upon the consent of all members other than the assignor.²⁰⁵ Such an assignee becomes a member at the time provided in, and upon compliance with, the operating agreement. If the operating agreement is silent, the assignee becomes a

member when the admission is reflected in the LLC's records.²⁰⁶ An assignee who becomes a member has, to the extent of the assignment, the rights and powers, and is subject to the restrictions and liabilities, of a member.²⁰⁷ Unless otherwise provided in the operating agreement, however, such an assignee is not liable for any of the assignor's obligations other than the obligation to make capital contributions.²⁰⁸ Moreover, the assignee is not liable for any obligations, including the assignor's obligation to make contributions, that were unknown to the assignee and not ascertainable from the operating agreement at the time of admission.²⁰⁹

Unless the operating agreement provides otherwise, a member who assigns all of his or her LLC interest ceases to be a member, regardless of whether or not the assignee becomes a member.²¹⁰ The rationale of this new provision may be that a person with no economic stake in the enterprise ought not to have a role in management.²¹¹ Therefore, an assignment of less than all of the member's interest²¹² or, unless otherwise provided in the operating agreement, assignment as security for a debt will not have this effect.²¹³

Also new in the KRLCA is a provision recognizing the charging order as a remedy by which a judgment creditor of a member can seek satisfaction by petitioning a court to charge the member's LLC interest with the amount of the judgment.²¹⁴ The charging order remedy originated in the Uniform Partnership Act in 1914.²¹⁵ The language in the

An interest in an LLC is personal property, consisting of a member's share of profits and losses and right to receive distributions of LLC assets.

198. K.S.A. 1999 Supp. 17-7663(h), -76,111.

199. *Id.* 17-76,112(c).

200. *Id.* 17-76,112(a).

201. *Id.* 17-76,106 states: "Notwithstanding anything to the contrary under applicable law, the operating agreement may provide that a limited liability company interest may not be assigned prior to the dissolution and winding up of the limited liability company."

202. *Id.* 17-76,112(a), (b)(1), -76,114(a). Actually, the statement in the text takes some liberties with the statutory wording. Both sections 17-76,112(a) and 17-76,114(a) literally provide that an assignee may only participate in management and become a member as provided in the operating agreement *and* upon approval of all members (other than the assignor) *or* compliance with any procedure provided in the operating agreement. Use of the conjunctive "and" literally means that if the operating agreement is totally silent on this matter, the assignee cannot participate in management or become a member, even if all other members consent. This literal interpretation of the statute makes no sense. If all of the other members approve admission, they could always amend the operating agreement to provide for admission and then admit the assignee. The intermediate step of amending the operating agreement, however, serves no useful function. Regardless of how this issue is resolved, if the assignor is the only member of the LLC, the assignee always will have the right to participate in management as a member. *Id.* 17-76,112(f).

203. *Id.* 17-76,112(b)(2).

204. *Id.* 17-76,112(d). Of course, an assignee may assume any such liability by agreement. *Id.*

205. *Id.* 17-76,114(a). See note 202, *supra*. The default requirement of unanimous consent is more stringent than that of prior law. See K.S.A. 17-7618 (repealed 2000).

206. K.S.A. 1999 Supp. 17-7686(b)(2).

207. *Id.* 17-76,114(b).

208. *Id.* An assignment of an LLC interest will not release the assignor from any liability to the LLC, whether or not the assignee becomes a member. *Id.* 17-76,114(c).

209. *Id.* 17-76,114(b).

210. *Id.* 17-76,112(b)(3). If the assignor ceases to be a member and the assignee does not become a member, the management, voting, and other noneconomic rights associated with the interest apparently disappear. The effect is to augment the corresponding rights of the other members.

211. If this is the rationale, it is at some level inconsistent with permitting a person to become a member without acquiring an LLC interest. See *id.* 17-7686(c). Equally inconsistent is the fact that this concept first appeared in limited partnership law in a formulation applicable to limited partners as well as general partners. See K.S.A. 56-1a101(h), -1a402.

212. Would retention by the assignor of some small percentage of his or her interest prevent termination of his or her status as a member? Unlike the KRLCA, an analogous provision of partnership law permits expulsion of a partner upon a transfer of "all or substantially all" of the partner's transferable interest in the partnership. K.S.A. 1999 Supp. 56a-601(d)(2).

213. *Id.* 17-76,112(b)(3). However, if the security interest is foreclosed and the LLC interest is sold, the effect is the same as a voluntary outright conveyance. In such a case the member should be held to have ceased to be a member. *Cf. id.* 56a-601(d)(2) (other partners cannot expel a partner who has transferred his or her transferable partnership interest for security purposes, or if the interest has been subjected to a creditor's charging order, if the security interest or charging order has not been foreclosed).

214. *Id.* 17-76,113.

215. UNIFORM PARTNERSHIP ACT § 28 (1914).

KRLCA, however, was taken directly from limited partnership law,²¹⁶ and simply authorizes the charging order and states that the charging creditor has the rights of an assignee of the LLC interest.²¹⁷ It says nothing about foreclosure, redemption, or other matters, but perhaps the courts will flesh the remedy out by reference to partnership law, which has had greater experience.²¹⁸

A member of an LLC is a person who has been admitted as a member in accordance with the KRLCA.

Finally, unless otherwise provided in the operating agreement, an LLC may acquire outstanding LLC interests by purchase, redemption, or otherwise, which interests, unless otherwise provided, are deemed canceled after acquisition.²¹⁹ This provision of the KRLCA, which is based on a 1994 amendment to the DLLCA,²²⁰ simply makes it clear that an LLC has the power to reacquire members' interests. The circumstances under which a repurchase or redemption may occur, the mechanics of any such transaction, and the effect on the members involved are left to the operating agreement or other agreement of the parties.

8. Termination of Membership

A member of an LLC is a person who has been admitted as a member in accordance with the KRLCA.²²¹ A person, in turn, may be an individual, a trust, an estate, or any one of a number of business organizations or other entities.²²² As such, there are a number of events that may occur that will make it practically and legally impossible for a person to continue as a member of an LLC. Examples include the following: voluntary resignation or withdrawal from the LLC; involuntary expulsion from the LLC; bankruptcy or similar financial embarrassment of the member; death or incompetency of an individual member; and dissolution or termination of a member that is a business organization, trust, or estate. Consistent with the theory that an LLC is a separate entity,²²³ the KRLCA continues the rule that none of these or similar events that terminate the membership of a member will cause dissolution and winding up of the LLC unless the operating agreement so provides, or unless members holding a majority of the profits interests in the LLC, or in each class or group of members, as appropriate, so desire.²²⁴ This section will consider the various events, to the extent the KRLCA specifically addresses them, from the point of view of the affected member.

The KRLCA's provisions regarding member resignation pull in different directions, creating a constructional problem. The relevant language is as follows:

A member may resign from a limited liability company *only* at the time or upon the happening of events specified in agreement [sic] and in accordance with the operating agreement. Notwithstanding anything to the contrary under applicable law, unless the operating agreement provides otherwise, a member *may* resign from a limited liability company prior to the dissolution and winding up of the limited liability company.²²⁵

It is clear from the first of these two sentences that if the operating agreement speaks to resignation, a member may resign as permitted by and in compliance with the agreement. It is equally clear from the second sentence that the operating agreement may limit or prohibit resignation. What is the default rule? What is the situation if the operating agreement is silent regarding resignation?

The trouble stems from use of the word "only" in the first sentence, making it appear that resignation is possible *only* if and when the operating agreement affirmatively permits it. The second sentence, however, clearly states that a member *may* resign unless the operating agreement affirmatively prevents it. This conflict should be resolved in favor of permitting resignation in cases in which the operating agreement is silent. This reading is not only better policy but also is mandated by the derivation of this language.

Like most of the KRLCA, the provision in question is based on the DLLCA, but in this instance with one major difference. The DLLCA provides that a member may resign *only* if and when permitted by the operating agreement. It then consistently, if redundantly, states the same proposition in the negative: that a member *may not* resign unless otherwise provided in the operating agreement.²²⁶ The drafters of the KRLCA reversed the import of the second sentence by deleting "not," but they neglected also to delete "only" from the first sentence.

A member who has resigned from an LLC has only the distribution rights granted by the operating agreement.²²⁷ More specifically, unless the operating agreement provides for a buyout, a resigned member is not entitled to be paid the fair value of his or her LLC interest.²²⁸ Rather, the member will be deemed to be an assignee and will have only the rights of an assignee.²²⁹ That is, the member will have the right to share in the profits and losses, to receive the distributions, and to receive the allocations of income, gain, loss, deduction, or credit to which the member otherwise was entitled, but will have relinquished all management, voting, information and other rights.²³⁰ The result under the default rules of the KRLCA is an investment that is as illiquid as stock in a closely-held corporation, but which lacks even the basic voting and information rights that a corporate shareholder would have. For this reason, unless the

216. See K.S.A. 56-1a403. The KRLCA adds a final sentence making clear that the charging order is the only remedy by which a judgment creditor of a member can reach the member's interest in the LLC. K.S.A. 1999 Supp. 17-76,113.

217. K.S.A. 1999 Supp. 17-76,113.

218. See *id.* 56a-504; *City of Arkansas City v. Anderson*, 242 Kan. 875, 752 P.2d 673 (1988); *City of Arkansas City v. Anderson*, 12 Kan. App. 2d 490, 749 P.2d 505, *rev. denied*, 243 Kan. 777 (1988).

219. K.S.A. 1999 Supp. 17-76,112(e).

220. See 69 Del. Laws, ch. 260, § 31 (1994).

221. K.S.A. 1999 Supp. 17-7663(l), -7686.

222. *Id.* 17-7663(m).

223. *Id.* 17-7673(b).

224. *Id.* 17-76,116(b).

225. *Id.* 17-76,106 (emphasis added).

226. DEL. CODE ANN. tit. 6, § 18-603 (1999).

227. K.S.A. 1999 Supp. 17-76,107.

228. *Id.*

229. *Id.* 17-76,106.

230. *Id.* 17-76,112(a), (b)(1), (2).

operating agreement provides for a buyout,²³¹ resignation from an LLC will rarely be an attractive alternative.²³²

Other than to note that it will not cause dissolution of an LLC unless the remaining members so desire,²³³ the KRLCA is silent about the circumstances under which a member might be expelled from an LLC and the consequences of such an expulsion.²³⁴ Lacking explicit statutory authority, an LLC's members should have no right to expel a fellow member unless the operating agreement specifically permits it, or, possibly, unless there is good cause for expulsion.²³⁵

In contrast to expulsion, the KRLCA specifies in detail the types of events indicating insolvency or financial instability that, unless otherwise provided in the operating agreement or with the unanimous written consent of the other members, will cause a member to cease to be a member.²³⁶ As in the case of a resigned member, a bankrupt or otherwise financially embarrassed member will become an assignee, retaining economic but not personal rights in the LLC.²³⁷

The situation of an individual member who dies or is adjudicated incompetent is similar. The deceased or incompetent member will cease to be a member, and the member's personal representative will have the rights of an assignee of the member's LLC interest.²³⁸

The termination of an estate or trust that is a member, and the dissolution of a business organization that is a member are not expressly covered by the KRLCA.²³⁹ Therefore, the operating agreement should address these situations. If it does not do so, it nevertheless is clear that the member will cease to be a member of the LLC. In each such case, unless the operating agreement provides otherwise, after paying its debts and liabilities the member will distribute its LLC interest to those beneficially interested in the member (legatees, heirs, beneficiaries, or equity participants). These persons literally will be assignees and will have the rights attendant upon that status.²⁴⁰ The terminating or dissolving member concomitantly will cease to be a member, as would any member who assigns all of the member's LLC interest.²⁴¹

B. Management

1. Management by Members

a. Internal Matters

Unless otherwise provided in an operating agreement, management of a Kansas LLC is vested in its members in proportion to their then current interests in profits, with the vote of a majority of such interests being necessary for action.²⁴² The default rule for authorization of transactions that are not in the ordinary course of business, however, is a majority in number of the members.²⁴³

b. Members as Agents

Prior law constituted each member of a member-managed LLC an agent of the LLC for purposes of its business. As such, each member had power to bind the LLC by any act for apparently carrying on the business in the usual way, unless the member in fact lacked authority and the person with whom the member was dealing had knowledge of the member's lack of authority.²⁴⁴ On the other hand, an act that was not for apparently carrying on the business in the usual way did not bind the LLC unless properly authorized, which, unless otherwise provided by the articles of organization or operating agreement, required the approval of a majority in number of the other members.²⁴⁵ Thus, under prior law, four things were clear: (i) the statute itself gave each member authority to bind the LLC in transactions in the ordinary course of business; (ii) such authority could be restricted by some proportion of the other members; (iii) such a restriction would be ineffective with respect to a third party unless the third party

The termination of an estate or trust that is a member, and the dissolution of a business organization that is a member are not expressly covered by the KRLCA.

231. The KRLCA gives an LLC power to purchase or redeem LLC interests. *Id.* 17-76,112(e).

232. Resignation will not release a member from any preexisting liability to an LLC. *Id.* 17-76,106.

233. *Id.* 17-76,116(b).

234. Compare *id.* 56a-601(c)-(e) (expulsion of partner from general partnership).

235. See Franklin A. Gevurtz, *Squeeze-Outs and Freeze-Outs in Limited Liability Companies*, 73 WASH. U.L.Q. 497, 520-21, 536-37 (1995).

236. K.S.A. 1999 Supp. 17-7689. The statute defines "bankruptcy" as a term of art to mean any of the events listed. *Id.* 17-7663(b).

237. *Id.* 17-7689, -76,112(a), (b)(1), (2).

238. *Id.* 17-76,115. See *id.* 17-76,112(a), (b)(1), (2). An exception is made in cases in which the deceased or incompetent member is the only member of the LLC. In such a case, the member's personal representative is vested with the management rights of a member. *Id.* 17-76,115.

239. Like expulsion, dissolution of a member is indirectly adverted to as an event that normally will not cause dissolution and winding up

of the LLC. See *id.* 17-76,116(b).

240. *Id.* 17-76,112(a), (b)(1), (2), (d), (f).

241. *Id.* 17-76,112(b)(3). A similar result would be reached in the case of a person who is a member by virtue of being the personal representative of an estate or trustee of a trust that terminates.

242. *Id.* 17-7693(a). Profits are allocated among the members as provided in the operating agreement. If the operating agreement is silent, profits are allocated on the basis of capital contributions. *Id.* 17-76,101. Although section 17-7693(a) does not expressly require it, it is possible that a majority in profits interest of each class or group of members will be required if an LLC has more than one class or group of members. See *id.* 17-7663(j). The constructional problem is that section 17-7693(a) does not precisely use the phrase "majority in interest."

243. *Id.* 17-7693(c). See text at notes 141-74, *supra*, for a discussion of members' meetings, voting, and related matters.

244. K.S.A. 17-7614(b) (repealed 2000).

245. *Id.* 17-7614(d) (repealed 2000).

knew of the restriction; and (iv) transactions not in the ordinary course of business required an affirmative conferral of actual authority by some proportion of the other members.

**An LLC's
operating
agreement
may provide
for
management,
in whole or in
part, by one
or more
managers.**

Unfortunately, the KRLCA represents a step backward. It states that, unless otherwise provided in an operating agreement, each member in a member-managed LLC has authority to bind the LLC.²⁴⁶ At least this overly broad statement is qualified as to transactions not in the ordinary course of business. As to such transactions, the KRLCA continues, almost verbatim, the rule of prior law that authorization is necessary and that, unless otherwise provided in the articles of organization or operating agreement, such authority must be granted by the vote of a majority in number of the other members.²⁴⁷ But what of transactions that are in the ordinary course of business? Clearly, the members may restrict each other's authority *inter se*,²⁴⁸ but what is the effect on third parties (point (iii), above)? In agency terminology, the KRLCA recognizes that a member's actual authority to carry on business in the usual way may be restricted by the operating agreement, but it completely neglects the question of apparent authority. Unless remedied by amendment, this change from prior law is sure to foster litigation.²⁴⁹

2. Management by Managers

a. In General

An LLC's operating agreement may provide for management, in whole or in part, by one or more managers.²⁵⁰ The manager or managers may, but are not required to be members.²⁵¹ The managers will manage the business, hold the offices, and have the responsibilities as provided in the operating agreement.²⁵² Thus, it is possible under the KRLCA for an LLC to have a management structure that, among other things, resembles a general partnership with

one or more managing partners, a limited partnership, or a corporation.

b. Admission, Resignation, Removal

Continuing the philosophy of prior law,²⁵³ the KRLCA mandates little about the selection of managers. It merely requires that they be chosen by the members, and leaves the method and frequency of selection to the operating agreement.²⁵⁴ Thus, a person may be named as manager in the operating agreement or designated as manager pursuant to any other procedure provided for in the operating agreement, including but not limited to annual election by the members.²⁵⁵

Similarly, a manager will cease to be such as provided in the operating agreement.²⁵⁶ Failure to be reelected or reappointed, resignation, removal, and death are obvious candidates. With specific reference to resignation, the KRLCA provides that a manager may resign at the time or upon the occurrence of events specified in, and in accordance with the operating agreement.²⁵⁷ It goes on to state that the operating agreement may prohibit resignation, but that, notwithstanding such a prohibition, a manager will retain the power to resign by giving written notice to the members and other managers.²⁵⁸ In cases in which a manager's resignation violates the operating agreement, the LLC may recover damages for breach of contract from the manager and offset the amount of the damages against any distribution due the manager.²⁵⁹

Any member or manager may bring an action in the district court to determine the validity of any admission, election, appointment, removal, or resignation of a manager. In such an action, the court may determine the right of any person to become or to continue to serve as manager, and may resolve conflicting claims to a particular manager's position.²⁶⁰

c. Internal Matters

If an operating agreement provides for management, in whole or in part, by managers, it also may provide for classes or groups of managers with such relative rights, powers, and duties as it may specify. In addition, the operating agreement may provide for creation in the future of

246. K.S.A. 1999 Supp. 17-7693(a) (repealed 2000).

247. *Id.* 17-7693(c). The references to articles of organization are not in keeping with the remainder of the statute. They may be an inadvertent carryover from prior law.

248. *Id.* 17-7693(a).

249. At present, the issue would be resolved by analogy to agency law, to which reference would be made under *id.* 17-76,135. RESTATEMENT (THIRD) OF AGENCY § 2.03 (Tent. Draft No. 1 2000) succinctly provides as follows:

Apparent authority is the power to affect a principal's legal relations with third parties held by an agent or other actor, when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations. When an agent holds a position within an organization, or has been placed in charge of a transaction or situation, a third party acts reasonably in believing that the agent has authority to do acts consistent with the position the agent occupies absent knowledge of circumstances that would lead a reasonable third party to inquire into the existence, extent, or nature of the agent's authority.

250. K.S.A. 1999 Supp. 17-7693(a).

251. *See id.* 17-7694. A person who is both a manager and a member will have the rights and powers, and be subject to the restrictions and liabilities of a manager. Except as provided in the operating agreement, the manager also will have the rights and powers, and be subject to the restrictions and liabilities of a member, to the extent of the manager's participation in the LLC as a member.

252. *Id.* 17-7693(a).

253. *See* K.S.A. 17-7612 (repealed 2000).

254. K.S.A. 1999 Supp. 17-7693(a).

255. *Id.* 17-7663(k), -7692.

256. *Id.* 17-7693(a).

257. *Id.* 17-76,105.

258. *Id.* No time frame is specified for the giving of notice.

259. *Id.*

260. *Id.* 17-7671(a).

additional classes or groups of managers, including those with rights, powers, and duties senior to those of existing managers.²⁶¹

The operating agreement is also the primary source of the voting rights of managers. It may grant to all, or to certain identified managers, or to specified classes or groups of managers, the right to vote on any matter. Such right to vote may be exercisable separately, or with all or any class or group of managers or members.²⁶² The operating agreement may structure manager voting on a per capita, number, financial interest, class, group, or any other basis. In the unlikely event that an operating agreement calls for management by managers but is silent as to the manner of voting, the KRLCA provides for per capita voting.²⁶³

If an LLC's operating agreement provides for multiple managers with voting rights, it also may contain whatever provisions as may be desired pertaining to notice of meetings, waiver of notice, record date, quorum requirements, proxy voting, action by written consent, or any other matter regarding voting.²⁶⁴ Unless the operating agreement provides otherwise, proxy voting by managers is permitted, and managers may act by written consent without a meeting if the consent or consents are signed by managers having not less than the minimum number of votes necessary to take the action at a meeting.²⁶⁵ The KRLCA affirmatively provides that written waiver of notice is equivalent to the giving of notice.²⁶⁶

Thus, although it is clear that the KRLCA contemplates meetings of managers, absent a mandate in the operating agreement it does not require that managers only act collectively at meetings in the way in which corporate law envisions that a board of directors should act. In fact, by statutorily designating each manager an agent of the LLC,²⁶⁷ the KRLCA creates a clear distinction between managers and corporate directors with regard to the exercise of managerial power.

In one final respect, however, the KRLCA returns to the corporate model in its treatment of an LLC's managers. Just as corporate law extends shareholders' inspection rights to directors for any purpose reasonably related to their positions as directors,²⁶⁸ so too are managers given members' inspection rights for any purpose reasonably related to their positions as managers.²⁶⁹

d. Managers as Agents

As to external matters, the KRLCA's provisions consist of

one new sentence followed by a nearly verbatim reenactment of prior law. The new sentence appears to give each manager a carte blanche by stating, without limitation, that unless the operating agreement provides otherwise, each manager has authority to bind the LLC.²⁷⁰ This general proposition is then immediately constrained by the KRLCA's replication of two precepts from prior law. First, if an LLC's articles of organization provide for management by managers,²⁷¹ every manager is an agent with the ability to bind the LLC to any transaction that constitutes carrying on in the usual way the business or affairs of the LLC, unless in fact the manager has no authority to act and the third party has knowledge that the manager lacks authority.²⁷² Second, 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 the articles or operating agreement, such authority must flow from a majority in number of the members, not the managers.²⁷³

Note that the first of these two precepts is conditioned on management structure being stated in the articles of organization, while the second is not. Thus, if management is vested in managers pursuant to the operating agreement rather than the articles of organization,²⁷⁴ the statutory agency power of the managers will be the same as that of members in a member-managed LLC.²⁷⁵ That is, they will have authority, due solely to their position, to bind the LLC except as to transactions not in the ordinary course of business.²⁷⁶ This authority can be restricted internally by the operating agreement,²⁷⁷ but the effect on third parties will be left unresolved by the statute, as it would not have been if the articles of organization had been the document to vest management in the managers.²⁷⁸ This seems an odd result, given that the KRLCA does not require the articles to contain information regarding management structure.²⁷⁹

The KRLCA's statutory scheme creates another anomaly as well. Once again, if the articles of organization provide for management by managers, the statute states that no member, acting solely as a member, has even the status of

The operating agreement may structure manager voting on a per capita, number, financial interest, class, group, or any other basis.

261. *Id.* 17-7695(a).

262. *Id.* 17-7695(b).

263. *Id.* The statute, however, fails to provide a default rule for the minimum number of votes necessary to take action. Compare K.S.A. 17-6301(b) (director action by vote of majority of directors present at meeting at which quorum present unless articles of incorporation or bylaws require greater number).

264. K.S.A. 1999 Supp. 17-7695(c).

265. *Id.* 17-7695(d). See note 263, *supra*. Both of the default rules mentioned in text are more liberal than analogous corporate law, which makes no provision for proxy voting by directors and which requires unanimity for director action by written consent. K.S.A. 17-6301(f).

266. K.S.A. 1999 Supp. 17-7695(e). Strangely, this provision is not drafted as a default rule.

267. See *id.* 17-7693(a), (b)(2), discussed in text at notes 270-79, *infra*.

268. K.S.A. 17-6510(d).

269. K.S.A. 1999 Supp. 17-7690(b).

270. *Id.* 17-7693(a).

271. Note that the articles of organization are no longer required to state the LLC's management structure. See *id.* 17-7673(a); text at notes 274-84, *infra*, for further discussion of this point.

272. K.S.A. 1999 Supp. 17-7693(b)(2). Compare K.S.A. 17-7614(c)(2) (repealed 2000).

273. K.S.A. 1999 Supp. 17-7693(c). Compare K.S.A. 17-7614(d) (repealed 2000).

274. See K.S.A. 1999 Supp. 17-7693(a). This is the general rule.

275. See text at notes 246-49, *supra*.

276. K.S.A. 1999 Supp. 17-7693(a), (c).

277. *Id.* 17-7693(a).

278. *Id.* 17-7693(b)(2).

279. See *id.* 17-7673(a).

an agent of the LLC.²⁸⁰ Under this provision, which is another carryover from prior law,²⁸¹ no member, as such, has any statutory power whatsoever to act for a manager-managed LLC, even as to ordinary matters.²⁸² On the other hand, if the articles of organization are silent regarding management, and it is the operating agreement that vests management in managers, this provision is inapplicable. This does not mean, however, that the members will be agents with power to bind the LLC. On the contrary, the KRLCA in the first instance only *gives* members authority to bind the LLC if the LLC is member-managed. If the LLC has managers, the plenary grant of authority to members is simply inapplicable, and it does not matter whether the management structure was created in the articles of organization or in the operating agreement.²⁸³

It is possible that the condition that management structure appear in the articles of organization was an attempt by the drafters to give the public at least constructive notice that the business was managed by managers before completely withdrawing agency status from the members. If so, the attempt was ill-conceived²⁸⁴ and ill-executed. Unless the operating agreement provides otherwise, members, as such, will *never* have authority to bind a manager-managed LLC. Therefore, third parties will always have the burden of verifying management structure, a burden that cannot be satisfied merely by checking the public record.

3. Delegation

Regardless of whether an LLC is being managed by its members, by managers, or in part by members and in part by managers, the KRLCA broadly authorizes delegation of

managerial rights and powers to other persons, including but not limited to agents, officers, and employees of a member, manager, or the LLC.²⁸⁵ Unless otherwise provided in the operating agreement, such delegation is permissible and may be accomplished, among other ways, by a management or other agreement. Unless the operating agreement provides otherwise, such delegation also will not cause the delegating member or manager to cease to be such.²⁸⁶

4. Fiduciary Duties

Fiduciary duties are status-based duties that the law superimposes on parties' relationships totally apart from whatever else they may have contracted for. The law of fiduciary duties historically has been judge-made, although legislatures seem inclined to act in this area with increasing frequency.²⁸⁷ Perhaps the most striking example of this trend is the Kansas Revised Uniform Partnership Act, which completely and preemptively codifies partners' fiduciary duties.²⁸⁸ The KRLCA, however, follows the opposite tack. After stating its policy of freedom of contract with specific reference to the operating agreement, it provides that *to the extent that* a member, manager, or other person has fiduciary duties, those duties may be expanded or restricted by the operating agreement. Moreover, good faith reliance on the operating agreement will be a defense to the imposition of liability.²⁸⁹ Thus, the KRLCA does not take a firm stand on whether fiduciary duties even exist in the context of an LLC, much less their nature and scope.

Nevertheless, it seems fairly clear that the judiciary will recognize the existence of fiduciary relationships in Kansas LLCs. The essence of a fiduciary relationship is a situation in which a person transacts business or handles money or other property, not primarily for his or her own benefit, but for the benefit of another. It is a relationship that involves discretionary authority on the part of the fiduciary and dependency and reliance on the part of the beneficiary.²⁹⁰

The relative youth of LLCs as a form of business organization means that there is no well established body of case

280. *Id.* 17-7693(b)(1).

281. See K.S.A. 17-7614(c)(1) (repealed 2000).

282. The question is not one of restricting the authority of a person otherwise an agent to conduct ordinary business on behalf of the LLC. Rather, the statute itself completely withdraws agency status from members in a manager-managed LLC.

283. K.S.A. 1999 Supp. 17-7693(a). It might be argued that members in a manager-managed LLC do have an agent's power to bind the LLC if the management structure is stated only in the operating agreement and not also in the articles of organization. The argument would be based on two premises. First, that the KRLCA is not intended to be preemptive; that it is not the sole source of a member's agency power. Second, that "authority" in section 17-7693(a) is used in the strict agency law sense of actual authority as between the members, and is not intended to encompass apparent authority as between the LLC and third parties. If one accepts both of these premises, it is possible to conclude that a member might have common law apparent authority to bind a manager-managed LLC, at least as to transactions in the ordinary course of business, unless the management structure is set forth in the articles of organization such that section 17-7693(b)(1) would be triggered.

284. The attempt, if there was one, was ill-conceived because, unlike prior law, management structure under the KRLCA still is not a

required item in the articles of organization. *Id.* 17-7673(a). *Id.* 17-7693(b) provides that certain consequences will follow if the articles vest management in managers, but even this section does not *require* inclusion. Therefore, inclusion would not result in binding constructive notice to anyone. *Id.* 17-7679. More to the point, notice is simply irrelevant. If members are not agents of an LLC, they completely lack statutory power to bind the LLC. There is no requirement in the statute that anyone have notice, actual or constructive, of this fact.

285. *Id.* 17-7698.

286. *Id.*

287. See, e.g., *id.* 17-6002(b)(8) (providing that articles of incorporation may limit or eliminate liability of director for monetary damages for breach of duty of care); K.S.A. 17-6304 (stating circumstances under which contract or transaction between corporation and director or officer will not be void or voidable solely on basis of conflict of interest).

288. K.S.A. 1999 Supp. 56a-404. See also UNIFORM LIMITED LIABILITY COMPANY ACT § 409 (1995) (codifying exclusive fiduciary duties of members and managers of LLCs).

289. K.S.A. 1999 Supp. 17-76,134(b), (c).

290. See, e.g., *Denison State Bank v. Madeira*, 230 Kan. 684, 640 P.2d 1235 (1982); RESTATEMENT (SECOND) OF AGENCY § 13 & cmt. a (1958).

law, in Kansas or elsewhere, dealing with fiduciary obligations. However, such a body of law is beginning to develop, and is doing so by analogy to the fiduciary principles applicable to general partnerships, limited partnerships, and corporations.²⁹¹

Traditionally, partners of general partnerships have been held to occupy a fiduciary relationship with respect to their copartners and the firm. The reasons are straightforward. Unless otherwise agreed, each partner has an equal right to participate in management of the business, with differences of opinion as to matters in the ordinary course of business being decided by majority vote.²⁹² Thus, in managing the business, each partner acts not only for himself or herself, but also for the benefit of his or her copartners--the earmark of a fiduciary relationship. Even if, by agreement, management power has been delegated to one or only a few of the partners, every partner, by law, remains an agent of the partnership with power to bind it to transactions in the ordinary course of business with third parties.²⁹³ As such, the reasons that underlie the fiduciary status of agents apply equally to general partners.²⁹⁴

Not surprisingly, the fiduciary status of partners in a general partnership carries over to general partners in a limited partnership.²⁹⁵ In fact, the duties of a general partner in a limited partnership may be even stricter than those applicable to a partner in a general partnership because of the typically passive and dependent role of the limited partners.²⁹⁶ On the other hand, for this same reason, limited partners ordinarily are not subject to fiduciary duties.²⁹⁷

Corporate law also reflects the general proposition that those who act in a representative or managerial capacity, and who therefore exercise discretionary authority over the property of others, occupy a fiduciary relationship to those whose property they control. Thus, corporate directors and officers consistently have been held to be fiduciaries of their corporation, and in modern times, also of its shareholders.²⁹⁸ Conversely, shareholders, as such, traditionally have not been regarded as fiduciaries because, when acting solely as shareholders, they act as owners and not in a managerial, representative capacity.²⁹⁹

This brief summary of partnership and corporate law suggests how fiduciary duties might be applied to members and managers of LLCs. If the LLC is member-managed, all members would be agents of the LLC and would occupy a fiduciary relationship to the LLC and to each other similar

to that of partners in a general partnership. If exclusive management power is vested in managers, the managers (whether or not they also are members) would be subject to fiduciary duties akin to those of corporate officers and directors or general partners of limited partnerships. The nonmanaging members, whose position is analogous to that of shareholders or limited partners, generally would not be subject to fiduciary obligations. If the LLC has adopted a hybrid structure, under which it has managers but certain managerial decisions are reserved to the members at large, each group would be subject to fiduciary responsibility within the sphere of its managerial authority. This is the general approach taken by the drafters of the Uniform Limited Liability Company Act³⁰⁰ and which may, over time, recommend itself to the Kansas courts.

To the extent the courts do recognize fiduciary obligations in the context of Kansas LLCs, two provisions of the KRLCA remain to be considered. The first of these relates to the duty of care, and closely tracks its corporate law counterpart. It protects a member or manager who relies in good faith on the LLC's records and on other information, opinions, reports, or statements presented to the LLC by any of its other members, managers, officers, employees, or committees, or by any other person who has been selected with reasonable care, as to matters the member or manager reasonably believes are within the person's professional or expert competence.³⁰¹ This protection specifically extends to good faith reliance on financial information affecting the legality of distributions by the LLC to members.³⁰²

The relative youth of LLCs as a form of business organization means that there is no well established body of case law, in Kansas or elsewhere, dealing with fiduciary obligations.

291. See generally 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES ch. 9 (1998).

292. K.S.A. 1999 Supp. 56a-401(f), (j).

293. *Id.* 56a-301(a).

294. REVISED UNIFORM PARTNERSHIP ACT § 404, cmt. 1 (1996) ("the law of partnership reflects the broader law of principal and agent, under which every agent is a fiduciary"); *Denison State Bank v. Madeira*, 230 Kan. 684, 640 P.2d 1235 (1982) (agency is a fiduciary relationship).

295. See K.S.A. 56-1a253(a), (c); *Newton v. Hornblower, Inc.*, 224 Kan. 506, 582 P.2d 1136 (1978).

296. 2 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 6.07(a)(3) (1998).

297. *In re Villa West Assocs.*, 193 B.R. 587, 592-94 (D. Kan. 1996); 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 9.09 at 9-32 (1998).

298. *Oberbelman v. Barnes Investment Corp.*, 236 Kan. 335, 690 P.2d 1343 (1984); *Blakesley v. Johnson*, 227 Kan. 495, 608 P.2d 908 (1980);

Newton v. Hornblower, Inc., 224 Kan. 506, 582 P.2d 1136 (1978); *Sampson v. Hunt*, 222 Kan. 268, 564 P.2d 489 (1977).

299. See *Ritchie v. McGrath*, 1 Kan. App. 2d 481, 571 P.2d 17, *rev. denied*, 222 Kan. 749 (1977). Recently, fiduciary obligations have been extended to controlling shareholders in transactions with the corporation or directly with minority shareholders, because of the potential for oppression, or at least unfair dealing, that control carries with it. *E.g.*, *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110 (Del. 1994).

300. See UNIFORM LIMITED LIABILITY COMPANY ACT § 409 (1995); Wayne M. Gazur, *The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role*, 58 LAW & CONTEMP. PROBS. 135, 156-59 (1995).

301. K.S.A. 1999 Supp. 17-7697. Compare K.S.A. 17-6301(e) (reliance by corporate directors).

302. K.S.A. 1999 Supp. 17-7697. See *id.* 17-76,110, discussed in text at notes 329-30, *infra*.

The second provision is section 17-7669, which reads as follows:

Except as provided in an operating agreement, a member or manager may lend money to, borrow money from, act as a surety, guarantor or endorser for, guarantee or assume one or more obligations of, provide collateral for, and transact other business with, a limited liability company and, subject to other applicable law, has the same rights and obligations with respect to any such matter as a person who is not a member or manager.³⁰³

On its face, this language might be read to validate one of the most serious conflict of interest situations—a contract or transaction between a fiduciary and a beneficiary. Whether the applicable law is that of agency,³⁰⁴ partnership,³⁰⁵ or corporations,³⁰⁶ these transactions are always viewed with suspicion. If one understands the historical derivation of section 17-7669, it becomes clear that it is not intended to be an across-the-board validation of such self-dealing contracts and transactions. Rather, its purpose is altogether different.

The first incarnation of this language appeared in section 13 of the original Uniform Limited Partnership Act (1916),³⁰⁷ which provided that a limited partner could loan money to and transact other business with the limited partnership and, with respect to resulting claims, share with general creditors a pro rata portion of the partnership's assets. Section 13 also contained a special fraudulent conveyance provision applicable to transactions between a limited partner and the limited partnership. Thus, its focus was not on the internal relationship between a limited partner and the limited partnership, but on the external relationship between the limited partner and third party creditors of the limited partnership.

The Revised Uniform Limited Partnership Act (1985) contains an updated version of section 13 in section 107, as follows:

Except as provided in the partnership agreement, a partner may lend money to and transact other business with the limited partnership and, subject to other applicable law, has the same rights and obligations with respect thereto as a person who is not a partner.³⁰⁸

Although this language is more general than that of section 13, the exclusive focus remains the relationship between the contracting partner and outside creditors. Thus, the drafters explain that the special fraudulent conveyance provision was deleted but that the rights of the contracting

partner were made subject to other applicable law, such as the state's general fraudulent conveyance law and the equitable subordination doctrine developed under federal bankruptcy law.³⁰⁹

Delaware adopted this version of section 107 when it enacted the Revised Uniform Limited Partnership Act in 1982.³¹⁰ In 1988 Delaware amended its provision to permit a partner also to "borrow money from, act as a surety, guarantor or endorser for, guarantee or assume one or more specific obligations of, [and] provide collateral for" a limited partnership.³¹¹ This language, with appropriate modifications, became part of the DLLCA,³¹² which is the model for the KRLCA. Nowhere in this history is there any suggestion that these provisions were intended to insulate fiduciary self-dealing from judicial scrutiny.

5. Indemnification

Prior law provided that an LLC could indemnify members, managers, and others to the same extent that a corporation could indemnify directors, officers, employees, or agents against actual and reasonable expenses incurred in connection with the defense of any civil or criminal action, suit or proceeding in which the member or manager was a party.³¹³ This provision merely gave the LLC power to indemnify; it did not require indemnification. Any right to be indemnified had to appear in the operating agreement or be authorized by the vote of the members or managers in a specific case.

The KRLCA expands indemnification in two significant respects. First, it provides that, subject to any standards or restrictions contained in the operating agreement, an LLC has power to indemnify and hold harmless members, managers, and others from and against any and all claims and demands whatsoever.³¹⁴ This is exceedingly broad language that would cover any sort of liability incurred by a member, manager, or other person, whether or not in the ordinary course of the LLC's business, and whether or not litigation had been commenced. As was true under prior law, no right to indemnification is created by this provision. Rather, it simply authorizes the parties, in the broadest possible terms, to strike their own bargain in the operating agreement.

The KRLCA does, however, also create a right to indemnification. Parroting corporate law, it states that, to the extent a member, manager, officer, employee, or agent has been successful, on the merits or otherwise, in defense of any action, suit, or proceeding, or any issue or matter therein, such person must be indemnified against actual and reasonable litigation expenses, including attorney fees.³¹⁵

303. K.S.A. 1999 Supp. 17-7669.

304. See RESTATEMENT (SECOND) OF AGENCY §§ 389-92 (1958).

305. See K.S.A. 1999 Supp. 56a-404(b)(2); K.S.A. 56-1a253(a), (c).

306. See K.S.A. 17-6304; *Oberhelman v. Barnes Investment Corp.*, 236 Kan. 335, 690 P.2d 1343 (1984).

307. UNIFORM LIMITED PARTNERSHIP ACT § 13 (1916); 1967 Kan. Sess. Laws, ch. 302, § 13 (repealed 1983, effective 1986).

308. REVISED UNIFORM LIMITED PARTNERSHIP ACT § 107 (1985); K.S.A. 56-1a107. Substantially the same language appeared in the KLLCA. See K.S.A. 17-7613 (repealed 2000).

309. REVISED UNIFORM LIMITED PARTNERSHIP ACT § 107 cmt. (1985).

310. 63 Del. Laws, ch. 420, § 1 (1982).

311. 66 Del. Laws, ch. 316, § 5 (1988), codified at DEL. CODE ANN. tit. 6, § 17-107 (1999).

312. DEL. CODE ANN. tit. 6, § 18-107 (1999).

313. 1998 Kan. Sess. Laws, ch. 121, § 6 (repealed 2000).

314. K.S.A. 1999 Supp. 17-7670(a).

315. *Id.* 17-7670(b). Compare K.S.A. 17-6305(c) (mandatory indemnification of corporate directors, officers, employees, and agents).

C. Profits, Losses and Distributions

1. Allocation

Allocation of profits and losses on the books of an LLC and allocation of actual distributions of cash or other assets both are governed by the operating agreement.³¹⁶ In the unlikely event that the operating agreement is silent as to either or both of these matters, allocation will be on the basis of the agreed value (as reflected in the LLC's records) of each member's capital contribution to the extent that the contribution has been received by the LLC and not previously returned to the member.³¹⁷ This default rule represents a change from prior law, which provided for equal allocation in the absence of an agreement to the contrary.³¹⁸

2. Interim Distributions

The question of how distributions are allocated among members, and among classes or groups of members, is different than the question whether a distribution, in fact, will be made. The latter is a management question that should be addressed in the operating agreement.³¹⁹ Absent specific provision in the operating agreement, members' draws or other interim distributions will be subject to whatever internal management structure governs ordinary business matters.

Unless the operating agreement provides 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 to the LLC.³²⁰ Conversely, unless the operating agreement affirmatively permits 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 percentage in which the member shares in distributions generally. On the other hand, unless the operating agreement prevents it, a member may be compelled to accept an in kind distribution to the extent it is not disproportionate.³²¹

Subject to provisions of the KRLCA designed to preserve the distinction between equity and debt,³²² and unless otherwise provided in the operating agreement, a member has the status of, and is entitled to all remedies available to, a creditor of the LLC with respect to accrued but unpaid distributions.³²³

3. Distribution Upon Dissociation

As had already been noted,³²⁴ a member who resigns or otherwise becomes dissociated from an LLC has only the distribution rights granted by the operating agreement. There is no statutory default right to return of the member's capital contribution, to the fair value of the member's LLC interest, or to any other amount.³²⁵ The KRLCA thus continues a trend away from easy withdrawal of members' investments begun in 1997.³²⁶ While, absent advance planning for a buyout, this renders members' interests highly illiquid, it serves the need of the typical closely-held LLC for a predictable capital base. It also helps preserve valuation discounts for purposes of federal transfer taxation in the case of family-owned LLCs.³²⁷

If an operating agreement does call for a distribution upon dissociation of a member, any such distribution is subject to the other provisions of the KRLCA that apply to distributions generally.³²⁸

4. Limitation on Distributions

An LLC may make distributions to its members only to the extent that the fair value of its assets exceeds its liabilities. For purposes of this computation, nonrecourse liabilities and liabilities to members with respect to their LLC interests are disregarded. Property subject to a nonrecourse liability is included as an asset only to the extent that its fair value exceeds the liability.³²⁹ A member who knowingly receives a distribution in violation of this limitation will be liable to the LLC for a period of three years for the amount of the distribution. A member who did not know at the time the distribution was made that it was wrongful will not be liable.³³⁰ In this regard, the protection for good faith reliance on financial information regarding the LLC's ability lawfully to make distributions³³¹ is especially significant.

Unless otherwise provided in an operating agreement, a member's obligation to return money or other property distributed in violation of the KRLCA may be compromised only by the unanimous consent of the other members.³³² Even if such a compromise has occurred, the member theoretically will remain liable to a creditor who extended credit to the LLC during the period the member's obligation to return the wrongful distribution was reflected in the operating agreement, to the extent the creditor reasonably relied on that obligation.³³³ Because an obligation to return

316. K.S.A. 1999 Supp. 17-76,101, -76,102. Recall that unless the operating agreement provides otherwise, members' voting power is allocated in accordance with profits. *Id.* 17-7663(j), -7687(d), (e), -7693(a).

317. *Id.* 17-76,101, -76,102. This default rule is especially significant for those who become members without making a contribution. *See id.* 17-7686(c). The operating agreement may set a record date for allocations and distributions. *Id.* 17-76,109.

318. K.S.A. 17-7615(b), (c) (repealed 2000).

319. K.S.A. 1999 Supp. 17-76,104.

320. *Id.* 17-76,108.

321. *Id.*

322. *See id.* 17-76,110, -76,119.

323. *Id.* 17-76,109.

324. *See text at notes 227-32, supra.*

325. K.S.A. 1999 Supp. 17-76,107.

326. *See* K.S.A. 17-7616, as amended by 1997 Kan. Sess. Laws, ch. 55, § 1 (repealed 2000).

327. *See* I.R.C. § 2704(b)(3)(B); 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 18.13 at 18-30 (1998).

328. K.S.A. 1999 Supp. 17-76,107. *See id.* 17-76,108 to -76,110.

329. *Id.* 17-76,110(a).

330. *Id.* 17-76,110(b), (c). "Knowledge" means actual, not constructive knowledge. *Id.* 17-7663(e). A member also may incur liability under other laws, such as the Kansas Uniform Fraudulent Transfer Act, *id.* 33-201 to -212. Unless otherwise agreed, however, no liability will be subject to a statute of limitations longer than the three-year statute provided in the KRLCA. *Id.* 17-76,110(b), (c).

331. *See id.* 17-7697.

332. *Id.* 17-76,100(b).

333. *Id.*

a wrongful distribution will rarely, if ever, appear in an operating agreement, the potential for liability under this provision is de minimus.

D. Annual Reports

Every domestic LLC and every foreign LLC doing business in Kansas must file with the Secretary of State an annual report, due at the same time as the LLC's Kansas income tax return.

Every domestic LLC and every foreign LLC doing business in Kansas must file with the Secretary of State an annual report, due at the same time as the LLC's Kansas income tax return. The report, on a form available from the Secretary of State's office, must state the name of the LLC and, if it is a domestic LLC, the name and address of each member owning a 5% or greater capital interest. A requirement that the report contain a reconciliation of the members' capital accounts for the previous tax year was deleted in 2000.³³⁴ 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. The actual amount of franchise tax paid by any LLC is required to be kept confidential by the Secretary of State.³³⁵

Failure to file an annual report or to pay the franchise tax when due will result in the assessment of a \$75 penalty.³³⁶ If the failure persists for 90

days, the LLC's articles of organization (if domestic) or authority to do business in Kansas (if foreign) will be forfeited.³³⁷ In such a case, the LLC may be reinstated by filing with the Secretary of State a certificate of reinstatement and paying all fees, taxes, and penalties due. A reinstatement is retroactive to the date of forfeiture, and the LLC may resume its business as though forfeiture had never occurred.³³⁸

E. Derivative Actions

Prior law did not expressly permit a member to bring a derivative action on behalf of an LLC. Following the lead of the DLLCA³³⁹ and the Kansas Revised Uniform Limited Partnership Act,³⁴⁰ the KRLCA now authorizes a member

to bring an action in the right of an LLC to recover a judgment in its favor.³⁴¹ This form of action, which has long been known to the corporate law,³⁴² may be especially useful when an LLC's management is centralized in one or more managers.

Derivative actions, by definition, are a minority remedy. Therefore, in order to preserve both management and democratic norms, a member's derivative suit is authorized only if the managers or members with authority to bring the action have refused to do so, or if an effort to cause them to bring the action is unlikely to succeed.³⁴³ This precondition is reinforced procedurally by the requirement that the petition in a derivative action set forth with particularity the effort of the plaintiff to secure initiation of the action by a manager or member or the reasons for not making the effort.³⁴⁴

A second procedural hurdle for the would-be derivative plaintiff is the so-called contemporaneous ownership rule.³⁴⁵ The KRLCA's version of this rule, which is intended to prevent speculation in litigation, states that the plaintiff must be a member of the LLC at the time of bringing the action and also must have been a member at the time of the transaction about which the plaintiff is complaining. Alternatively, the plaintiff's status as a member may have devolved on the plaintiff by operation of law or pursuant to the operating agreement from a person who was a member at the time of the transaction.³⁴⁶

Finally, if a derivative action is successful, in whole or in part, whether by way of judgment, compromise, or settlement, the court has discretion to award the plaintiff reasonable litigation expenses, including attorneys' fees. The award may be payable from the recovery in the action, if any, or directly by the LLC.³⁴⁷

III. ORGANIC CHANGES

A. Conversions

1. Conversion of Other Entity to LLC

Prior law provided a simplified procedure by which a general or a limited partnership could convert into an LLC without dissolving and reorganizing.³⁴⁸ The KRLCA expands the types of "other entity" that may convert into a Kansas LLC to include a business trust, real estate investment trust, common law trust, or any other unincorporated

334. *Id.* 17-76,139(a), (b), as amended by 2000 Kan. Sess. Laws, ch. 172, § 4.

335. *Id.* 17-76,139(c), as amended by 2000 Kan. Sess. Laws, ch. 172, § 4.

336. *Id.* 17-7509, -76,139(d), as amended by 2000 Kan. Sess. Laws, ch. 172, § 4.

337. K.S.A. 17-7510; K.S.A. 1999 Supp. 17-76,139(d), as amended by 2000 Kan. Sess. Laws, ch. 172, § 4.

338. K.S.A. 1999 Supp. 17-76,139(d), (e), as amended by 2000 Kan. Sess. Laws, ch. 172, § 4.

339. See DEL. CODE ANN. tit. 6, §§ 18-1001 to -1004 (1999).

340. See K.S.A. 56-1a551 to -1a554.

341. K.S.A. 1999 Supp. 17-76,130. Delaware extends the right to sue

derivatively to assignees of LLC interests. DEL. CODE ANN. tit. 6, §§ 18-1001, -1002 (1999).

342. A brief sketch of the theory and history of shareholder derivative actions appears in *Ross v. Bernhard*, 396 U.S. 531, 534-35 (1970).

343. K.S.A. 1999 Supp. 17-76,130.

344. *Id.* 17-76,132.

345. See, e.g., FED. R. CIV. P. 23.1; K.S.A. 56-1a552, 60-223a.

346. K.S.A. 1999 Supp. 17-76,131.

347. *Id.* 17-76,133.

348. See 1996 Kan. Sess. Laws, ch. 135, § 6 (repealed 2000) for the most recent version of this provision.

business, including a general partnership, limited partnership, limited liability partnership, limited liability company, or foreign limited liability company.³⁴⁹ The conversion must be approved as provided in the other entity's organizational documents or by applicable law, as the case may be.³⁵⁰ It is accomplished by filing with the Secretary of State a certificate of conversion and articles of organization that comply with the KRLCA, each of which has been executed by one or more authorized persons.³⁵¹

The certificate of conversion must state: (a) the date on which and jurisdiction in which the other entity was formed, and if different, its jurisdiction immediately prior to conversion; (b) the other entity's name immediately prior to conversion; (c) the name of the LLC into which it is converting; and (d) if the conversion is not to be immediately effective, the future effective date or time (which may not be later than 90 days after the filing date).³⁵² The conversion is effective upon filing the certificate of conversion and articles of organization with the Secretary of State or upon the future effective date specified in those instruments.

Upon effectiveness, the other entity is converted into a Kansas LLC without the necessity of dissolving, winding up its business, or liquidating and distributing its assets. Rather, the other entity simply will continue in the form of an LLC, the existence of which is retroactive to the original date of formation of the other entity.³⁵³ Notwithstanding this retroactivity, the conversion will not affect any obligations or liabilities of the other entity, or the personal liability of any person, incurred prior to conversion.³⁵⁴

When another entity is converted into an LLC, all rights, powers, privileges, title to all property, debts due, and causes of action belonging to the other entity are deemed vested in the LLC. Similarly, all rights of creditors, liens, debts, liabilities, and duties of the other entity continue without impairment, attach to the LLC, and may be enforced against it to the same extent as if incurred or contracted by it.³⁵⁵

2. Conversion of LLC to Other Entity

Going a step beyond prior law, the KRLCA also permits a Kansas LLC to convert into a domestic business trust, real estate investment trust, common law trust, general partnership, limited partnership, or limited liability partnership.³⁵⁶ Such a conversion must be authorized as provided in the LLC's operating agreement.³⁵⁷ If the operating agreement does not speak to authorization of a conversion, but contains provisions governing authorization of a merger or consolidation, then those provisions will control. If, how-

ever, the operating agreement is silent with respect to both conversions and mergers or consolidations, the conversion must be authorized by a majority in profits interest of the members, or if there is more than one class or group of members, then by a majority in profits interest of each class or group.³⁵⁸

Beyond specifying how a conversion must be authorized, the KRLCA does not detail the filing and other procedures necessary to accomplish conversion of an LLC into another entity. Such matters quite properly are left to the law governing the other entity. Unfortunately, the statutes, if any, governing the other entities into which an LLC might convert contain no reciprocal provisions.³⁵⁹

B. Mergers and Consolidations

1. Merger or Consolidation with Other LLCs

Prior law authorized a domestic LLC to merge or consolidate with or into one or more domestic or foreign LLCs. The KRLCA reenacts these provisions with only two substantive additions.³⁶⁰

The first, and least important of these additions, relates to an agreement of merger or consolidation that is amended or terminated after its approval but before the effective date of the corresponding certificate of merger or consolidation. In such a situation the KRLCA makes provision for filing with the Secretary of State of a certificate that amends or terminates the certificate of merger or consolidation, so that the public record will reflect accurately the business reality.³⁶¹

The second change is a section expressly authorizing an operating agreement or an agreement of merger or consolidation to provide contractual appraisal rights in connection with any merger or consolidation, amendment of the operating agreement, or sale of all or substantially all of the LLC's assets.³⁶² Unlike corporate law, this provision does not grant appraisal rights to dissenters,³⁶³ it merely authorizes the parties to create their own contractual appraisal rights. It does, however, eliminate any doubt about the propriety of such rights in an operating agreement or agree-

Prior law authorized a domestic LLC to merge or consolidate with or into one or more domestic or foreign LLCs. The KRLCA reenacts these provisions with only two substantive additions

349. K.S.A. 1999 Supp. 17-7684(a). Delaware includes corporations among the other forms of business entity that may convert into an LLC. See DEL. CODE ANN. tit. 6, § 18-214(a) (1999).

350. K.S.A. 1999 Supp. 17-7684(h).

351. *Id.* 17-7684(b).

352. *Id.* 17-7684(c).

353. *Id.* 17-7684(d), (g).

354. *Id.* 17-7684(e).

355. *Id.* 17-7684(f).

356. *Id.* 17-7685. Delaware also permits an LLC to convert into a corporation. See DEL. CODE ANN. tit. 6, § 18-216 (1999).

357. An operating agreement may prohibit conversion of an LLC into some other form of unincorporated business organization. See K.S.A. 1999 Supp. 17-7685.

358. *Id.* 17-7663(j), -7685.

359. See K.S.A. & 1999 Supp. 17-2027 to -2038, 56-1a01 to -1a609, 56a-101 to -1305.

360. Compare K.S.A. 17-7650 (repealed 2000) with K.S.A. 1999 Supp. 17-7681.

361. K.S.A. 1999 Supp. 17-7681(c).

362. *Id.* 17-7682.

363. See *id.* 17-6712.

ment of merger or consolidation. It also specifically confirms jurisdiction in the district court to hear and determine any matter relating to such appraisal rights.³⁶⁴

2. Merger or Consolidation with Other Business Entities

Since 1995, Kansas law has contained specific and separate provisions authorizing and governing a merger or consolidation involving a domestic LLC and one or more other domestic or foreign business entities at least one of which is not an LLC.³⁶⁵ These provisions are unaffected by the KRLICA.

IV. DISSOLUTION AND WINDING UP

A. Causes of Dissolution

1. Nonjudicial Dissolution

An LLC is dissolved and its affairs must be wound up upon the first to occur of the following: (a) at the time specified in the operating agreement (if no time is specified, the LLC will have perpetual existence);³⁶⁶ (b) upon the happening of events specified in the operating agreement; (c) unless otherwise provided in the operating agreement, upon the written consent of a majority in profits interest of the members, or if there is more than one class or group of members, then a majority in profits interest of each class or group; (d) at any time there are no members, except that, unless otherwise provided in the operating agreement, the LLC is not dissolved if, within 90 days (or such other period provided in the operating agreement) after the event that terminated the membership of the last remaining member, that member's personal representative agrees in writing to continue the LLC and to the admission of the personal representative or his or her nominee as a member of the LLC, retroactively effective as of the event that terminated the membership of the last remaining member.³⁶⁷

Continuing a provision added to the prior law in 1998,³⁶⁸ the KRLICA states affirmatively that, unless otherwise provided in the operating agreement, the death, retirement, expulsion, bankruptcy, dissolution, or occurrence of any other event that terminates the membership of any member will not cause the dissolution and winding up of an LLC. Rather, the LLC will continue unless, within 90 days after the event, a majority in profits interest of the members, or if there is more than one class or group of members, then a majority in profits interest of each class or group, agree in writing to dissolve the LLC.³⁶⁹

364. *Id.* 17-7682.

365. 1995 Kan. Sess. Laws, ch. 245, §§ 5-13, codified at K.S.A. & 1999 Supp. 17-7701 to -7709.

366. As the rest of the provision makes clear, "perpetual" is used in the sense of indefinite rather than in the sense of eternal.

367. K.S.A. 1999 Supp. 17-76,116(a)(1)-(4). *Id.* 17-76,115 provides that the personal representative of the last remaining member has a statutory right to participate in management as a member.

368. 1998 Kan. Sess. Laws, ch. 36, § 3 (repealed 2000).

369. K.S.A. 1999 Supp. 17-76,116(b). The only significant difference

2. Judicial Dissolution

An LLC also may be dissolved by a decree of the district court in two very different kinds of circumstances at the instance of two very different kinds of petitioners.³⁷⁰ The first is simply a reenactment of prior law, and involves suit by the Attorney General to dissolve involuntarily an LLC that is abusing its franchise in any of several ways.³⁷¹ The second borrows three pages from corporate law to create a truly innovative LLC dissolution provision.³⁷²

Recall that unless the operating agreement specifies the time at which or events upon the happening of which an LLC will dissolve, dissolution normally will require agreement among the holders of at least a majority of the profits interest in the business.³⁷³ If ownership is equally divided, deadlocks may develop with respect to both management of the business and the advisability of dissolution. If these deadlocks cannot be resolved the business will stagnate and may well eventually founder, to the detriment of all concerned.

It is to this type of situation that section 17-76,117(b) is directed. It requires that an LLC's business be suffering or at least be threatened with irreparable injury because the members or managers are so deadlocked with respect to management that the vote necessary for action cannot be obtained and the members cannot terminate the deadlock. In such a case any member or members owning in the aggregate 25 percent or more of the outstanding interests in either capital or profits may file a petition with the district court requesting dissolution and distribution of the LLC's assets in accordance with a plan to be agreed on by the members, or failing agreement, as determined by the court. The petition must be accompanied by a proposed plan of dissolution and distribution along with a certificate stating that copies of the petition and plan were furnished to the other members at least 30 days before the petition was filed, and that members having the vote required for dissolution have failed or refused to agree to the plan. Unless members having the vote required for dissolution file an answer and certificate stating that they have agreed to the proposed plan or some alternative, the court must order dissolution of the LLC if it finds that the deadlock and irreparable injury in fact exist as alleged.³⁷⁴

B. Winding Up and Distribution of Assets

1. Winding Up

The KLLCA was not clear as to precisely who, within a dissolved LLC, was vested with authority to wind up its affairs.³⁷⁵ Nor did it contain a specific procedure for

is that prior law required the agreement of "a majority in interest" of the members, or of each class or group of members, without defining that term as relating to profits, capital, or both.

370. *Id.* 17-76,116(a)(5), -76,117.

371. Compare *id.* 17-76,117(a) with K.S.A. 17-7629 (repealed 2000).

372. See K.S.A. 17-6516(a)(2), -7212(a)(1); K.S.A. 1999 Supp. 17-6804(d).

373. K.S.A. 1999 Supp. 17-76,116(a)(1)-(3), (b).

374. *Id.* 17-76,117(b).

375. See K.S.A. 17-7624(c) (repealed 2000).

appointment of a receiver, if necessary. In *Investcorp, L.P. v. Simpson Investment Co., L.C.*,³⁷⁶ however, the Kansas Supreme Court held that the managers in office at the time of dissolution were responsible for winding up. It further held that the district court had jurisdiction to appoint a receiver upon a showing of fraud, breach of fiduciary duty, waste, or other good cause.

The KRLCA essentially codifies these aspects of the *Investcorp* holding. It states that, unless otherwise provided in the operating agreement, a manager who has not wrongfully dissolved an LLC may wind up its affairs.³⁷⁷ If there is no such manager, the members or a person approved by the members may wind up the LLC.³⁷⁸ In either case, however, the district court, upon cause shown, may wind up the LLC's affairs and appoint a liquidating trustee upon the application of any member, manager, personal representative, or assignee.³⁷⁹

The persons winding up the LLC have authority to litigate on its behalf, gradually settle and close its business, liquidate its property, pay or make provision for payment of its liabilities, and distribute its remaining assets to its members, all without affecting the liability of its members or managers and without imposing personal liability on any liquidating trustee.³⁸⁰

2. Distribution of Assets

Upon completion of winding up, an LLC must first pay or make reasonable provision for payment of all of its known liabilities, including claims and obligations that are contingent, conditional, or unmatured, regardless of whether the identity of the claimant is known. Claims of members and managers who are creditors are included in this category to the extent otherwise permitted by law, unless the claim is for an accrued but unpaid interim distribution or distribution upon resignation.³⁸¹ If the LLC has sufficient assets, all creditors' claims must be paid or provided for in full. If assets are insufficient such claims are paid or provided for according to their priority, and among those of equal priority, ratably.³⁸²

After paying or providing for liabilities to creditors, unless the operating agreement provides otherwise, the LLC must

satisfy its liability to members and former members for the amount of any accrued but unpaid distributions upon resignation.³⁸³ Finally, unless otherwise provided in the operating agreement, any remaining assets will be distributed to the members, first for the return of their contributions, and second with respect to their LLC interests in the proportions in which they share in distributions.³⁸⁴

C. Certificate of Cancellation

Dissolution procedure under prior law burdened both the parties and the Secretary of State with unnecessary paperwork. As soon as possible after an event causing dissolution, the LLC had to file with the Secretary of State a statement of intent to dissolve.³⁸⁵ Later, after completion of the winding up process, the LLC filed a second document, articles of dissolution.³⁸⁶ If the articles of dissolution were in proper form and substance, and all fees and franchise taxes had been paid, the Secretary of State issued a certificate of dissolution to the LLC's representative, at which point the LLC's existence officially terminated.³⁸⁷

The KRLCA greatly simplifies this procedure by providing that, upon dissolution and completion of winding up, an LLC's articles of organization are to be canceled by filing a certificate of cancellation, executed by an authorized person, with the Secretary of State.³⁸⁸ The certificate of cancellation need only set forth the following: (1) the LLC's name; (2) the reason for filing the certificate; (3) if cancellation is not to be effective immediately, the future effective date or time of cancellation (which must be a date or time certain not later than 90 days after the filing date); and (4) any other information the person filing the certificate determines.³⁸⁹

V. FOREIGN LIMITED LIABILITY COMPANIES

As was the case with mergers and consolidations, the KRLCA reenacts the prior law governing foreign LLCs with only minor additions.³⁹⁰ The first of these is an incorporation by reference of the provisions regarding the types of businesses or activities in which an LLC may engage and the powers it possesses.³⁹¹ The second addition makes

376. 267 Kan. 840, *modified*, 267 Kan. 885, 983 P.2d 265 (1999).

377. K.S.A. 1999 Supp. 17-76,118(a). Although the statute is worded in the singular, there is no reason to believe it is intended to prevent winding up by more than one manager.

378. As is usual under the KRLCA, unless the operating agreement provides otherwise, the members must act by a majority in profits interest or, if there is more than one class or group of members, then by a majority in profits interest of each class or group. *Id.*

379. *Id.*

380. *Id.* 17-76,118(b), -76,119(b).

381. *Id.* 17-76,119(a)(1), (b). The exclusion of members' claims for accrued but unpaid distributions is made necessary by *id.* 17-76,109, which gives members the status of creditors with respect to such claims. This provision, which assumes an ongoing LLC, does not convert the underlying equity nature of such claims to debt upon liquidation of the business.

382. *Id.* 17-76,119(b).

383. *Id.* 17-76,119(a)(2). Liabilities with respect to accrued but unpaid interim distributions and distributions upon resignation are both excluded from first tier payment by *id.* 17-76,119(a)(1). *Id.* 17-76,119(a)(2) erroneously includes only liability for distributions upon resignation in the second tier. *Compare* DEL. CODE ANN. tit. 6, § 18-804(a)(1), (2) (1999).

384. *Id.* 17-76,119(a)(3). Unless the operating agreement provides otherwise, members share distributions in proportion to the agreed value of their contributions. *Id.* 17-76,102. It is unclear whether *id.* 17-76,108, relating to distributions in kind, is intended to apply to liquidation distributions to members. *Compare* K.S.A. 17-7624(d) (repealed 2000) (after paying or providing for its liabilities, LLC may distribute its assets, in cash or in kind, to its members).

385. 1998 Kan. Sess. Laws, ch. 36, § 3 (repealed 2000); K.S.A. 17-7623 (repealed 2000).

386. K.S.A. 17-7626, -7627(a) (repealed 2000).

387. *Id.* 17-7627, -7628 (repealed 2000).

388. K.S.A. 1999 Supp. 17-7675, -7676(a), -7678(a). Articles of organization also are canceled upon failure to maintain a resident agent, failure to file an annual report or pay the required franchise tax, effectiveness of a merger or consolidation in which the LLC is not the surviving or resulting entity, or conversion of the LLC into another form of business entity. *Id.* 17-7666(d), (e), -7675, -7681(d), -7685, -76,139(d).

389. *Id.* 17-7675.

390. *Compare id.* 17-76,120 to -76,129 with K.S.A. 17-7636 to -7644 (repealed 2000).

391. K.S.A. 1999 Supp. 17-76,120(b). See text at notes 22-29, *supra*.

clear that a foreign business entity is not itself "doing business" in Kansas solely by reason of being a member or a manager of a Kansas or foreign LLC.³⁹² Finally, the KRLCA extends to foreign LLCs, again by incorporation, the proposition that execution of a document filed with the Secretary of State constitutes an oath or affirmation under the penalties of perjury that, to the best of the signer's knowledge and belief, the facts stated in the document are true.³⁹³

VI. CONCLUSION

As stated at the outset, during the decade of the 1990s, amendment of the KLLCA became an almost annual event. Although these amendments had the commendable purpose and effect of improving the law, they could not alter the fact that the underlying legislation was a first generation LLC statute. Much has been learned in a decade. That knowledge, combined with the "check the box" Treasury Regulations has caused many states to undertake broad reviews of their LLC statutes. Delaware has not totally recodified its law but, not surprisingly, it has taken pains to remain in the forefront of the modernization movement. By using the DLLCA as a model, Kansas has not only modernized, but also clarified and rationalized many aspects of its LLC law.

The KRLCA is now retroactively applicable to all Kansas LLCs, regardless of when formed.³⁹⁴ Because most of the substantive changes made by the KRLCA are merely default rules, compliance should not be a major problem for most preexisting LLCs. Nevertheless, caution and the fact that the new statute offers significant advances over the old should prompt careful review of the articles of organization and operating agreements of all LLCs.

392. K.S.A. 1999 Supp. 17-76,121.

393. *Id.* 17-76,128.

394. *Id.* 17-76,140.

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