

# CHOICE OF ENTITIES

**15<sup>th</sup> Annual Essentials of Business Law**

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# Presenters



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# Five Business Entity Forms in Both Texas and Delaware

- Corporation
- Limited liability company (LLC)
- Limited partnership
- Limited liability partnership (LLP)
- General partnership

We focus on LLCs in Texas and Delaware because in both states more LLCs are being formed than any other state by a wide margin, but discuss other entities for comparison, and because courts in LLC cases may refer to precedent regarding other entities.

References herein to “*EGAN ON ENTITIES*” (and the sections and pages therein) are references to *EGAN ON ENTITIES: Corporations, Partnerships and Limited Liability Companies in Texas* (Fourth Edition, 2023), which is available from CSC and LexisNexis as follows:

[blog.cscglobal.com/the-fourth-edition-of-egan-on-entities-captures-recent-legislative-changes-to-offer-in-depth-analysis-of-texas-entities/](https://blog.cscglobal.com/the-fourth-edition-of-egan-on-entities-captures-recent-legislative-changes-to-offer-in-depth-analysis-of-texas-entities/)

# Texas Secretary of State—Statistical Information

Certificates of formation filed for calendar year ended December 31, 2022	
Domestic for-profit corporation	23,083
Domestic limited liability company	351,055
Domestic limited partnership	4,636
Domestic nonprofit corporation	14,455
Domestic professional corporation	662
Domestic professional association	227
Domestic LLP	446

Note: In Texas over 15 LLCs formed for each for-profit corporation in 2022.

# Texas Secretary of State—Statistical Information

Master file statistics as of January 1, 2023	
Entity type	Active entities
Domestic for-profit corporation	358,239
Domestic limited liability company	1,740,308
Domestic limited partnership	126,317
Domestic nonprofit corporation	176,623
Domestic professional corporation	16,789
Domestic professional association	17,181
Domestic LLP	3,959

# Delaware Secretary of State—Statistical Information

Certificates of formation filed for calendar year 2022	
Domestic for-profit corporation	58,662
Domestic limited liability company	231,196
Domestic limited partnership	21,193
Master file statistics for January 1, 2023	
Entity type	Active entities
Domestic for-profit corporation	386,254
Domestic limited liability company	1,403,986
Domestic limited partnership	148,372

Note: In Delaware almost 4 LLCs formed for each for-profit corporation in 2022

# Texas Business Organizations Code

- Enacted by the Texas Legislature in 2003.
- Became effective for new entities formed under Texas law after Jan. 1, 2006. **[TBOC §§ 1.002(20); 402.001]**
- After Jan. 1, 2010, TBOC governs all Texas entities. **[TBOC § 402.005]**
- Referred to as **TBOC** or **Code**.
  - See *EGAN ON ENTITIES* § 1.3 (12-25)

# Texas Business Organizations Code

- TBOC codified source law.
- TBOC has been amended every legislative session, including the regular session ended May 29, 2023, in response to cases and other states' statutory changes.
- The TBOC spoke provisions principally applicable to LLCs are found in TBOC Title 3, Chapter 1, § 101.001 *et seq.*, and the applicable hub provisions are principally in TBOC Title 1, Chapters 1-2.



# Delaware Limited Liability Company Act

- Delaware LLCs are formed under, and governed by, the Delaware Limited Liability Company Act (DLLCA).

# S-Corp Restrictions

## S-Corporations must:

- Be a domestic corporation;
  - However, may not be an ineligible corporation such as certain financial institutions, insurance companies, and domestic international sales corporations
- Have only allowable shareholders;
  - Shareholders may only be individuals, certain trusts, and estates
  - Shareholders may NOT be partnerships, corporations or non-resident alien shareholders
- Have no more than 100 shareholders; and
- Have only one class of stock.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC vocabulary—Texas

- The owners of a Texas LLC are called members and are analogous to shareholders in a corporation or limited partners of a limited partnership.
- The managers of an LLC are generally analogous to directors of a corporation and are elected by the members in the same manner as corporate directors are elected by shareholders.
- Under the TBOC, however, an LLC may be structured so that management shall be by the members as in the case of a close corporation or a general partnership, and in that case, the members would be analogous to general partners in a general or limited partnership but without personal liability for the LLC's obligations. Under the TBOC, any individual, corporation, partnership, LLC, or other person may become a member or manager. Thus, it is possible to have an LLC with a corporation as the sole manager just as it is possible to have a limited partnership with a sole corporate general partner.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC vocabulary—Delaware

- LLCs formed under Delaware law are governed by the Delaware Limited Liability Company Act (DLLCA).
- As in Texas, the owners of a Delaware LLC are called members and are analogous to stockholders of a Delaware corporation.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC formation and governing documents—Texas

- **Certificate of formation:**

- A Texas LLC is formed when one or more persons file a certificate of formation with the Texas Secretary of State along with a filing fee.
- The initial certificate of formation must contain: (1) the name of the LLC, (2) a statement that it is an LLC, (3) its purpose, which may be any lawful purpose for which LLCs may be organized, (4) the period of its duration, unless such duration is perpetual, (5) the street address of its initial registered office and the name of its initial registered agent at that address, (6) the initial mailing address of the filing entity (a change effective January 1, 2022), (7) if the LLC is to have a manager or managers, a statement to that effect and the names and addresses of the initial manager or managers, or if the LLC will not have managers, a statement to that effect and the names and addresses of the initial members, (8) the name and address of each organizer, and (9) specified information if the LLC is to be a professional LLC. Commencing September 1, 2023, an amended and restated Certificate of Formation for an LLC may omit the names and addresses of the initial managers and the mailing addresses of the registered office.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC formation and governing documents—Texas

- **Certificate of formation:**

- The changing of managers does not require an amendment to the certificate of formation. Since September 1, 2021, changing from manager-managed to member-managed (or vice versa) is done by amending the company agreement or certificate of formation. The LLC is required to update its management information each year on the Public Information Report filed with the Texas Comptroller of Public Accounts.
- An LLC's existence as such begins when the secretary of state files the certificate of formation, unless it provides for delayed effectiveness as authorized by the TBOC.
- An LLC may also be formed pursuant to a plan of conversion or merger, in which case the certificate of formation must be filed with the certificate of conversion or merger, but need not be filed separately.
- A Texas LLC may generally be formed to conduct any lawful business, subject to limitations of other statutes which regulate particular businesses, and generally it has all the powers of a Texas corporation or limited partnership, subject to any restrictions imposed by statute or its governing documents.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC formation and governing documents—Texas

- **Certificate of formation:**

- The name of an LLC must contain words or an abbreviation to designate the entity's nature, such as "limited liability company," "limited company," or an abbreviation of either phrase. The name must not be the same as, or deceptively similar to, that of any domestic or foreign filing entity authorized to transact business in Texas unless the existing entity with the similar name consents in writing.
- The certificate of formation may contain any other provisions not inconsistent with law.
- The TBOC provides that, except as otherwise provided in an LLC's certificate of formation or company agreement, the affirmative vote, approval, or consent of all members is required to amend its certificate of formation.
- Effective September 1, 2021, under TBOC section 2.115, an LLC's (or other domestic entity's) governing documents may provide that any internal affairs claim must be brought only in a court in Texas. In *Salzberg v. Sciabacchi*, 227 A. 3d 103 (Del. 2020) the Delaware Supreme Court held that DGCL § 102(b)(1) validates forum selection provisions in a certificate of incorporation for internal affairs claims, including claims under the Securities Act of 1933. See *EGAN ON ENTITIES* § 2.2.2(c) (66-78).

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC formation and governing documents—Texas

- **Company agreement:**
  - Most of a Texas LLC's organization and management provisions and the terms governing its securities are in its company agreement, which typically contains provisions similar to those in limited partnership agreements and corporate bylaws.
    - Under the TBOC, the company agreement may be written, implied, or oral (subject to the statute of frauds), controls the majority of LLC governance matters, and generally trumps the default TBOC provisions relating to LLCs, (although TBOC § 101.054 provides certain provisions of the TBOC may not be waived or modified by company agreement).
    - For example, under the TBOC, the company agreement or certificate of formation may only be amended by unanimous member consent. However, if either document provides otherwise (such as for amendment by manager consent), then it may be amended pursuant to its own terms.



# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC formation and governing documents—Texas

- **Company agreement:**

- A Texas company agreement will ordinarily contain the capital account and other financial and tax provisions found in a typical limited partnership agreement, but the TBOC does not require that the members ever approve the company agreement, file it with the secretary of state, or otherwise make a public record.
- Nevertheless, the members may wish to approve the company agreement and express their desire to be contractually bound by the company agreement. This should facilitate the company agreement's enforcement and its treatment as a "partnership agreement" for federal income tax purposes.
- Under the TBOC, a company agreement is enforceable by or against an LLC regardless of whether the LLC has signed or otherwise expressly adopted the company agreement.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC formation and governing documents—Texas

- **Company agreement:**
  - TBOC § 101.001 provides that a single-member LLC's company agreement is enforceable even though there's only one party to the agreement.
  - Under the TBOC, a member has no right to withdraw, and cannot be expelled, from the company unless the company agreement provides otherwise.
  - TBOC § 101.205 provides that a member who validly exercises its right to withdraw under a company agreement provision is entitled to receive the fair value (a term not defined in the TBOC) of the member's interest within a reasonable time unless the company agreement otherwise provides.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC formation and governing documents—Delaware

- **Certificate of formation:**
  - The certificate of formation must include the LLC's name, the address of its registered office, its registered agent's name and address for service of process, and any other matters the members determine to include.
  - It is formed upon filing its certificate of formation with the Delaware Secretary of State.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### LLC formation and governing documents—Delaware

- **Limited liability company agreement:**

- In Delaware, the agreement is referred to as the limited liability company agreement (referred to in Texas as the company agreement).
- The term “limited liability company agreement” is broadly defined in DLLCA § 18-101(7) to be the principal governing document of a Delaware LLC and to encompass “any agreement ... written, oral or implied, of the member or members as to the affairs of a limited liability company or its business.”
- A limited liability company agreement is not subject to any statute of frauds (including § 2714 of Title 6). Del. Code Ann. tit. 6, § 18-101.
- A member, manager, or assignee of an LLC is bound by the LLC agreement whether or not a signatory thereto.
- An LLC agreement may be amended according to its terms or, if the LLC agreement does not provide for its amendment, its members’ unanimous approval.
- Single member LLCs are expressly authorized.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Management—Texas

- If an LLC is manager-managed, its managers oversee its business and affairs, functioning like a board of directors, and may designate officers and other agents to act on the LLC's behalf.
- A manager may be an individual, corporation, or other entity, and an LLC may have a single manager that is a corporation or other entity.
- However, the certification of formation or the company agreement may provide that the LLC's members will manage some or all of the LLC's business and affairs. Thus, an LLC could be organized to be run without managers, like a close corporation, or structured so that managers run the day-to-day operations, but members must approve significant actions, as in the case of many joint ventures and closely held corporations.
- The company agreement should specify who has the authority to obligate the LLC contractually or to empower others to do so. It should dictate the way its managers (or members) may manage the LLC's business and affairs.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Management—Texas

- The company agreement should specify how managers are selected, their terms of office, and how they may be removed.
- The TBOC authorizes governing documents to contain “emergency” provisions that provide alternative governance provisions (such as action without a quorum) during the emergency.
- TBOC § 101.254(a) provides that the following are an LLC’s agents: (1) any officer or other agent who is vested with actual or apparent authority; (2) each manager (to the extent that management of the LLC is vested in that manager); and (3) each member (to the extent that management of the LLC has been reserved to that member).
- If a person named in TBOC § 101.254(a) takes an act to apparently carry on the LLC’s business in the usual way (like executing an instrument in the LLC’s name), then that person binds the LLC unless (1) the person lacks authority to act for the LLC and (2) the third party knows they lack authority. Lenders and others dealing with an LLC can determine with certainty who has authority to bind the LLC by referring to its certificate of formation, company agreement, and resolutions, just as in the case of a corporation. Wherever verification of authority is unusual in the corporate context, it is unusual in the LLC context.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Management—Delaware

- The DLLCA provisions relating to LLC management are comparable to the TBOC's and largely defer to the LLC agreement.

# Federal Income Taxes

[*EGAN ON ENTITIES*” Appendix A (613-685)]

- Check-the-box, “*EGAN ON ENTITIES*” Appendix A (613-685); Appendix C (709-717)
- **Corporations**
  - Rates Shareholders taxed on dividends at 21%
  - Flat tax rate: 21%
  - Immediate deduction of depreciable tangible assets, including assets acquired from a third party
  - Interest deduction limited to approximately 30% of EBITDA
  - For corporations with \$1 billion in average adjusted financial statement income in previous three years, an alternative minimum tax (“CAMI”) of 15% of such income for years beginning after December 31, 2022



# Qualified Small Business Stock (QSBS)

## Eligibility:

- Must be an active business that is incorporated as a U.S. C-Corporation;
- Must have had gross assets of \$50 Million or less at all times before and immediately after the equity was issued;
- At least 80% of the company's assets must be actively used in a qualified trade or business;
  - Certain excluded business types include, for example, performing services related to health, law, engineering, performing arts, farming, operating hotels/restaurants, and production of certain products.
- Company must issue the stock directly (i.e., not through secondary markets).

## Benefits:

- Upon the sale of QSBS, 100% of the gain is excluded from federal income tax, up to \$10 Million or 10x the seller's tax basis, whatever is greater.

# Federal Income Taxes

- **Partnerships and LLCs**

- Flow-through entities with no entity level tax
- Tax at owner level at individual rates ranging up to 37% plus 3.8% Unearned Income Medicare Contribution Tax (net investment income tax) on the lesser of (1) the taxpayer's net investment income for the tax year or (2) the excess of modified adjusted gross income for the tax year over the threshold amount of \$200,000 (\$250,000 in the case of joint filers and surviving spouses, and \$125,000 in the case of a married taxpayer filing separately)
- Non-corporate investors in businesses (other than specified service businesses) conducted through partnerships and LLCs can deduct approximately 20% of their business income subject to income limits

# Texas Margin Tax

## [*EGAN ON ENTITIES* Appendix B (687-707)]

- Enacted in 2006
- Margin tax returns due May 15 for calendar year taxpayers
- Applies to all business entities
  - Exceptions: (i) general partnerships which are not LLPs and all of whose partners are individuals and (ii) entities 90% of whose gross income is from narrowly defined passive income sources
  - Does not apply to sole proprietorships
- Margin tax base is taxable entity's (or unitary group's) gross receipts after deductions for the largest of:
  - W2 Compensation
  - Cost of goods sold (per the Texas Tax Code definition)
  - 30% of gross receipts
  - \$1,000,000
- Looks like income tax, but in 2012, Texas Supreme Court in *In re Allcat Claims Service, LP.*, 365 S.W.3d 455 (Tex. 2011) held not income tax

# Texas Margin Tax

## [*EGAN ON ENTITIES*” Appendix B (687-707)]

- Apportion to Texas: multiply the tax base by a fraction:
  - Texas gross receipts
  - U.S. gross receipts
- Tax rate for 2023 applied to the Texas portion of the tax base is 0.75%
  - Exception for retail and wholesale businesses, which pay a 0.375% rate
- Margin tax changes the calculus for entity selections, but not necessarily the result
  - LLC has become more attractive as it can elect to be taxed as a corporation or partnership for federal income tax purposes. [*EGAN ON ENTITIES*” Appendix A (616-623); Appendix C (709-717)]
  - Uncertainties as to an LLC’s treatment for self employment purposes can restrict its desirability in some situations. [*EGAN ON ENTITIES*” Appendix A (662-669)]

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- The TBOC does not address specifically whether managers or members have fiduciary or other duties—it doesn't even attempt to define them. But it implies that these duties may exist under statutory provisions that permit a company agreement to expand or restrict them (and a company may even limit or eliminate the liabilities for the breaching them).
- In a manager-managed LLC, the managers' duty (and in a member-managed LLC, the members' duty) to the LLC is generally assumed to be fiduciary, measured by reference to the fiduciary duties of corporate directors if the company agreement doesn't say otherwise. Managers' fiduciary duties could also be measured by reference to partnership law or the law of agency.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- By analogy to corporate directors, managers would have the duties of obedience, care, and loyalty and should have the benefit of the business judgment rule. Like a corporate director who, theoretically, represents all the corporation's shareholders (rather than those who are responsible for his being a director), a manager should be deemed to have a fiduciary duty to all the members. Whether members owe a fiduciary duty to the other members or the LLC will likely be determined by reference to corporate principles unless the certificate of formation or company agreement says otherwise.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- TBOC §§ 101.052, 101.054 and 101.401 allow LLC company agreements to expand, restrict, or waive the duties (including fiduciary duties) and liabilities of members, managers, officers, and other persons to the LLC or to its members or managers. To the extent that any or all fiduciary duties are waived, there would be no fiduciary duty to breach, thus eliminating any liabilities for breach of fiduciary duty.
- TBOC § 7.001 allows for the limitation or elimination of liability to the LLC or its owners or members for breaches of fiduciary or other duties of its managers and, in the case of a member-managed LLC, of those members with management responsibilities except for a breach of the duty of loyalty, bad faith, a transaction in which the person received an improper personal benefit, or an act for which liability is provided by statute.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- A company agreement provision restricting or eliminating fiduciary duties and limiting or eliminating liability for breaches thereof as permitted by TBOC §§ 7.001 and 101.401 could read as follows:
  - This agreement is not intended to, and does not, create or impose any fiduciary or other duty on any member or manager. Furthermore, each of the members, the managers, and the company hereby, to the fullest extent permitted by applicable law [defined to mean the TBOC and other applicable Texas and federal statutes and regulations thereunder], restricts, limits, waives, and eliminates any and all duties, including fiduciary duties, that otherwise may be implied by applicable law and, in doing so, acknowledges and agrees that the duties and obligations of each member or manager to each other and to the company are contractual in nature and are only as expressly set forth in this agreement and that no member or manager shall have any liability to the company or any other member or manager for any act or omission except as specifically provided by applicable law or in this agreement or another written agreement to which the member or manager is a party. The provisions of this agreement, to the extent that they restrict, limit, waive, and eliminate the duties and liabilities of a member or manager otherwise existing at law or in equity, are agreed by the members to replace such other duties and liabilities of such members or managers.



# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- Notwithstanding anything to the contrary contained in this agreement, it is contractually agreed that:
  - (i) the managers shall not permit or cause the company to engage in, take, or cause any of the following actions except with the prior approval of not less than a majority of the outstanding voting units: *[list specific actions]*;
  - (ii) the members and managers and each of their respective affiliates are permitted to have, and may presently or in the future have, investments or other business relationships, ventures, agreements, or arrangements (i) with entities engaged in the business of the company, other than through the company (an "other business") and (ii) with *[additional entity specifics]*; *[provided, that any transactions between the company and an other business will be on terms no less favorable to the company than would be obtainable in a comparable arm's-length transaction]*; and
  - (iii) there shall be a presumption by the company that any actions taken in good faith by the manager on behalf of the company shall not violate any fiduciary or other duties owed by the managers to the company or the members.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- Provisions such as the foregoing are often subject to intense negotiations and some investors may not agree to the limitations on duties and liabilities that those in control propose.
- Unlike Delaware, in Texas, a common-law duty of good faith and fair dealing does not exist in all contractual relationships. Rather, the duty arises only when a contract creates or governs a “special relationship” between the parties. A special relationship may be present in an LLC, and has been recognized where there is unequal bargaining power between the parties and a risk exists that one of the parties may take advantage of the other based upon the imbalance of power, e.g., insurer-insured. The elements which make a relationship special are absent in the relationship between an employer and an employee, but may be present in an LLC.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- While there are no reported Texas cases as to whether a contractual duty of good faith and fair dealing exists between members in an LLC, or between managers and members in a Texas LLC, it is likely that the duty of good faith and fair dealing exists in those LLC relationships, just as fiduciary duties likely exist, except to the extent that the fiduciary duty has been restricted or eliminated by contract or governing document as permitted by the TBOC. See *Allen v. Devon Energy Holdings, L.L.C. F/K/A Chief Holdings, L.L.C. and Trevor Rees-Jones*, 367 S.W.3d 355, 379-80 (Tex. App—Houston [1st Dist.] 2012), pet. granted, *judgment set aside and remanded by agreement*, *Devon Energy Holdings v. Allen*, 2013 Tex. LEXIS 20 (Tex. Jan. 11, 2013)) (“The vast majority of other intermediate appellate courts of this state have declined to recognize a formal fiduciary duty by a majority shareholder to a minority shareholder in a closely-held corporation while recognizing that an informal fiduciary duty could exist depending on the circumstances of the case. Given this overwhelming weight of authority ... [w]e therefore decline to recognize such a fiduciary duty between members of an LLC on this basis.”)

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- TBOC § 101.601(c) now provides that nothing in the subchapter shall be construed to limit the application of the principle of freedom of contract. Additionally, the legislative history and scope of § 2.20B of the Texas LLC Act, the precursor to TBOC § 101.401, indicate that even before its current wording was added, there was more latitude to exculpate LLC managers and members for conduct that would otherwise breach a fiduciary duty under the TBOC than under provisions of the TBOC relating specifically to corporations.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- TBOC § 101.255 provides that, unless the certificate of formation or company agreement provides otherwise, a transaction between an LLC and one or more of its managers or officers, or between an LLC and any other LLC or other entity in which one or more of its managers or officers are managers, directors, or officers or have a financial interest, shall be valid notwithstanding the fact that the manager or officer is present or participates in the meeting of managers, or signs a written consent, which authorizes the transaction or the manager's votes are counted for such purpose, if any of the following is satisfied:
  - (i) The material facts as to the transaction and interest are disclosed or known to the governing authority, and the governing authority in good faith authorizes the transaction by the approval of a majority of the disinterested managers or members (as appropriate) even though the disinterested managers or members are less than a quorum; or

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Texas

- (ii) The material facts as to the transaction and interest are disclosed or known to the members, and the transaction is approved in good faith by a vote of the members; or
  - (iii) The transaction is fair to the LLC as of the time it is authorized, approved, or ratified by the managers or members.
- In a joint venture, the duty of a manager to all members could be an issue since the managers would often have been selected to represent the interests of particular members. The issue could be addressed by structuring the LLC to be managed by members who would then appoint representatives to act for them on an operating committee which would run the business in the name of the members. In such a situation, the members would likely have fiduciary duties analogous to partners in a general partnership.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Delaware

- The DLLCA does not codify manager or member fiduciary duties, but expressly permits LLCs to eliminate fiduciary duties (although not all Delaware LLC agreements effectively do so).
- DLLCA § 18-1104 provides that unless modified in an LLC's governing documents, common law fiduciary duties apply to LLCs.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Delaware

- Delaware statutes governing partnerships and LLCs provide that their policy is to give maximum effect to the principle of freedom of contract and to entity agreements. See "*EGAN ON ENTITIES*," §§ 3.5 (461-463); 4.6 (474-491); 5.4 (516-537).
- DLLCA § 18-1101 aggressively adopts a "contractarian approach" (*i.e.*, Delaware respects the parties' bargains manifested in LLC agreements and statute and common law rarely trump these bargains). The DLLCA does not have any provision that itself creates or negates member or manager fiduciary duties. Instead it allows an LLC agreement to modify or eliminate fiduciary duties—although it does not allow the LLC agreement to eliminate "the implied contractual covenant of good faith and fair dealing."
- In Delaware, LLCs and partnerships are sometimes called alternative entities because their deference to contracts allows them more flexibility in governance than corporations.



# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Delaware

- An LLC agreement eliminating fiduciary duties as permitted by DLLCA § 18-1101 could include the following:
  - “Except as expressly set forth in this agreement or expressly required by the Delaware Act, no manager or member shall have any duties or liabilities, including fiduciary duties, to the company or any member, and the provisions of this agreement, to the extent that they restrict, eliminate, or otherwise modify the duties and liabilities, including fiduciary duties, of any manager or member otherwise existing at law or in equity, are agreed by the company and the members to replace such other duties and liabilities of the managers and members; provided that nothing here shall be construed to eliminate the implied contractual covenant of good faith and fair dealing under Delaware law.”
- Provisions like this are often subject to intense negotiations. Some investors may not agree to the limitations on duties and liabilities that those who would be in control may propose.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Fiduciary duties—Delaware

- Provisions in LLC agreements purporting to limit fiduciary duties need to be explicit and conspicuous. An LLC agreement's coyness can make it unenforceable. LLC agreement language to the effect that no member or manager shall be liable for any act or omission unless attributable to gross negligence, fraud, or willful misconduct provides limited exculpation from monetary liabilities. But courts might find that a bad faith limit on exculpation assumes rather than eliminates common law fiduciary duties. *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, C.A. No. 3658-VCS, 2009 WL 1124451, 2009 Del. Ch. LEXIS 54 (Del. Ch. April 20, 2009).
- Persons who control members can be responsible for breaching fiduciary duties to the members. In Delaware, a legal claim exists for aiding and abetting a breach of fiduciary duty, whether arising under statute, contract, common law, or otherwise.

# Delaware Corporate Fiduciary Duties

- Like Texas, Delaware corporate fiduciary duty common law, which is relevant to LLCs, embraces the duties of care and loyalty (including judicial deference to the informed business judgment of disinterested directors). See “*EGAN ON ENTITIES*” § 2.6.4 (133-187).
- Unlike Texas, Delaware holds that directors may be found to have violated the fiduciary duty of loyalty when they fail to act in the face of a known duty to act (i.e., they act in bad faith) which was first articulated by *In re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996). See “*EGAN ON ENTITIES*” § 2.6.4(a)(5) (141-151).

# Delaware Corporate Fiduciary Duties

- In June 2019, *Caremark* was followed by the Delaware Supreme Court in *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019), which involved Blue Bell Creameries USA, Inc., a Delaware subchapter S corporation headquartered in Brenham, Texas, which through subsidiaries made and distributed ice cream tainted with *listeria* bacteria. Eight people were sickened (three of whom died), Blue Bell had to recall its products, suspend operations, and lay off over a third of its workforce, and then entered into a highly dilutive transaction with a private equity investor. Blue Bell's board was sued in a derivative action alleging that the directors breached their fiduciary duty of loyalty.

# Delaware Corporate Fiduciary Duties

- The Delaware Supreme Court held that, while Blue Bell had food safety programs in place and “nominally complied with FDA regulations,” “the complaint alleges that Blue Bell’s board had no committee overseeing food safety, no full board-level process to address food safety issues, and no process by which the board was expected to be advised of food safety reports and developments ... Thus, the complaint alleges specific facts that create a reasonable inference that the directors consciously failed ‘to attempt to assure a reasonable information and reporting system exist[ed].’” To “satisfy their duty of loyalty,” the Supreme Court held, “directors must make a good faith effort to put in place a reasonable system of monitoring and reporting about the corporation’s central compliance risks.” Without more, the existence of management-level compliance programs was not enough for the directors to avoid touch Caremark exposure in a monoline company that makes a single food product—ice cream—and in which the company’s “mission critical” compliance issue is food safety.

# Delaware Corporate Fiduciary Duties

- The *Marchand* decision suggests that boards of directors of Delaware corporations should have special committees tasked with monitoring the entity's corporate risks and compliance protocols, or otherwise be prepared to show that there is board-level consideration of the entity's compliance risks.
- There are a number of other *Caremark* cases after *Marchand*, including *Juan C. Rojas derivatively on behalf of J.C. Penney Company*, C.A. No. 2018-0755-2018-0755-AGB (Del. Ch. July 29, 2019); *In re Clovis Oncology, Inc. Derivative Litigation*, C.A./Mp/3027-0222-JRS (Oct. 1, 2019); *In re LendingClub Derivative Litigation*, C.A. No. 12984-VCM (Del. Ch. Oct. 31, 2019); *In re Hughes v. Hu*, C.A. No. 2019-0112-JTL (Del. Ch. April 27, 2020); *In re The Boeing Company Derivative Litigation*, C.A. No. 2019-0907-MTZ (Del. Ch. Sept. 7, 2021); and *City of Detroit Police and Fire Retirement Sys. V. Hamrock*, C.A. Ni, 2021-0370-KSJM (June 30, 2022). The theory of *Caremark* likely will surface in Delaware LLC disputes.

# Delaware Corporate Fiduciary Duties

- *Caremark* has not been adopted by Texas courts. Duty of oversight claims in Texas courts should be treated as duty of care claims under *Gearhart Industries v. Smith International*, 741 F.2d 707 (5<sup>th</sup> Cir. 1984); *Ritchie v. Rupe*, 443 S.W.3d 857 (Tex. 2014); and *Sneed v. Webre*, 469 S.W.3d 169 (Tex. 2015); and the strong Texas deference to the business judgment of directors expressed therein. *But cf. In re Life Partners Holdings, Inc.*, 2015 WL 8523103 (W.D. Texas 2015).

# Texas Business Courts

- Prior to September 1, 2024, disputes regarding Texas entities are to be tried in Texas courts have typically been tried in general jurisdiction District Courts with elected judges, for which by trial by jury is generally available. Appeals go to intermediate Courts of Appeals and ultimately to the Texas Supreme Court.
- In 2023 the Texas Legislature passed House Bill 19 (“*H.B. 19*”) to create a specialized system of business courts (“*Business Courts*”), analogous to the Delaware Court of Chancery.
- H.B. 19 will take effect on September 1, 2023, but will initially apply only to actions commenced on or after September 1, 2024 in five major metropolitan areas (Austin, Dallas, Fort Worth, Houston and San Antonio). See H.B. 19 Section 5 (effective date); H.B. 19 Section 1, *to be codified at* Tex. Gov’t Code Ann. § 25A.003.
- Appeals from the Business Courts will be heard by a newly-created 15th Court of Appeals and ultimately by the Texas Supreme Court. H.B. 19 Section 1, *to be codified at* Tex. Gov’t Code Ann. § 25A.007.
- Any potential challenges to the constitutionality of H.B. 19 will be decided by the Texas Supreme Court which has original jurisdiction over them. H.B. 19 Section 4.



# Texas Business Courts

- Business Court Judges will be appointed by the governor, with the advice and consent of the Texas Senate, to two-year terms (and may be reappointed upon the expiration of a term). H.B. 19 Section 1, *to be codified at* Tex. Gov't Code Ann. § 25A.009. Judges must be Texas licensed attorneys possessing specialized knowledge, expertise and at least 10 years of experience in complex commercial disputes and transactions, and must have been a resident of a county within the division of the Business Court to which the judge is appointed for at least 5 years. H.B. 19 Section 1, *to be codified at* Tex. Gov't Code Ann. § 25A.008.
- H.B. 19 includes provisions for (a) the adoption by the Supreme Court of procedural rules and (b) the issuance of written opinions by the Business Courts, which would have precedential value and would serve to enhance commercial certainty regarding the litigation of certain business issues. H.B. 19 Section 1, *to be codified at* Tex. Gov't Code Ann. §§ 25A.020, 25A.016.
- Business Court cases may be tried to a jury when required by the Constitution. H.B. 19 Section 1, *to be codified at* Tex. Gov't Code Ann. § 25A.015.

# Texas Business Courts

- The new Business Courts will have jurisdiction over cases where the amount in controversy exceeds \$5 million for derivative proceedings, breach of fiduciary duty claims, matters of corporate governance, claims for piercing the corporate veil, and securities claims. H.B. 19 Section 1, *to be codified at* Tex. Gov't Code Ann. § 25A.004(b).
- The Business Courts will also have jurisdiction to decide disputes where the amount in controversy exceeds \$10 million for cases involving (a) qualified financing transactions with parties other than banks, credit unions and savings and loan associations, and (b) business transactions, such as purchase and sale agreements or mergers, in which the parties agreed, either initially or subsequently, to Business Court jurisdiction other than insurance contracts. H.B. 19 Section 1, *to be codified at* Tex. Gov't Code Ann. § 25A.004(d).
- If a party to the case is a publicly traded company or the case involves a party seeking only injunctive or declaratory relief, the Business Courts can decide derivative proceedings, breach of fiduciary duty claims, matters of corporate governance and securities claims, regardless of the amount in controversy. H.B. 19 Section 1, *to be codified at* Tex. Gov't Code Ann. § 25A.004(c).
- Delaware Courts
  - Disputes in Delaware regarding LLCs are typically tried in the Delaware Court of Chancery, which is an equity court of limited jurisdiction and which has judges appointed by the Governor. Del. Code Ann. tit. 10, § 341 (jurisdiction); DEL. CONST. art. 4, § 3; *cf.* Del. Code Ann. tit. 10, § 1909 (appointment of judges). Chancery Courts do not have jury trials. See Del. Code Ann. tit. 10, § 369 (providing that issues of fact triable by jury may be tried in the Superior Court). Appeals from the Chancery Court go directly to the Delaware Supreme Court. DEL. CONST. art. 4, § 11. Delaware also has law courts which have jury trials.

# Joint Ventures

- A joint venture (JV) is a relationship typically between two or three entities to accomplish a defined objective, and may take form of a contract or an entity. See “*EGAN ON ENTITIES*” § 1.5 (40-48).
- Traditionally, a JV was thought of as limited purpose general partnership—but today a JV more likely will be an LLC.
- Contributions to a JV can range from an established business unit with people and knowledge to cash or a license of IP (perhaps technology which one party has and needs funds and marketing muscle of other to develop; could be two parents putting together underperforming units to generally get off balance sheet).
- Expectations range from development of a product or project to a stand-alone business where the exit strategy is an IPO or sale of the JV. The exit strategy could also be dissolution of JV and distribution to partners.

# Joint Ventures

- A JV may be contractual relationship or an entity.
- In the United States, the LLC is now the entity of choice for JVs (principally limited liability with flexibility to be taxed as corporation or partnership and ability to limit fiduciary duties).
- *Dernick Resources Inc. v. Wilstein*, 312 S.W.3d 864 (Tex. App.—Houston [1st Dist.] 2009, no pet.), illustrates the dangers of using the term “joint venture” in contractual arrangements (O&G drilling and production contract that called itself “joint venture agreement” held to create fiduciary duty of disclosure on managing venturer). See “*EGAN ON ENTITIES*” §1.5 (40).

# Joint Ventures

- *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.*, 593 S.W.3d 732 (Tex. 2020) involved a series of preliminary agreements between Energy Transfer Partners, L.P. and Enterprise Product Partners, L.P. See “*EGAN ON ENTITIES*” § 1.5 (41-48).
- ETP and Enterprise entered into these preliminary agreements which provided that the obligations of the parties were conditioned on the execution of a definitive joint venture agreement and approvals by their respective boards of directors. Although no definitive joint venture agreement had been signed, the parties proceeded to spend time and money on the project and they communicated publicly that a joint venture had been formed and marketed the pipeline to potential customers. The parties’ marketing efforts did not produce enough commitments to ship through the proposed new pipeline to meet their agreed minimum threshold. Enterprise terminated its participation in the project and shortly thereafter entered into agreements with another large pipeline company for an alternative crude oil pipeline.

# Joint Ventures

- ETP sued Enterprise in state court alleging this breached Enterprise's contractual obligations and fiduciary duties to ETP. Notwithstanding the express provisions in preliminary agreements that no party was bound unless and until definitive agreements were signed, ETP claimed, and the jury found, that the parties' ensuing conduct served to form a Texas law general partnership and that Enterprise's negotiation and agreement with the other pipeline breached its fiduciary duty of loyalty to ETP. A judgment for \$535 million was entered in favor of ETP.
- The Texas Supreme Court held that no partnership was created because the NDA and letter of intent provided that no party was bound to proceed with a transaction unless and until a definitive agreement was executed by the parties after the approval thereof by the governing authorities of the parties, which never happened.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Business combinations—Texas

- TBOC Chapter 10 contains merger provisions that allow an LLC to merge with one or more LLCs or “other entities” (i.e., any corporation, limited partnership, general partnership, joint venture, joint stock company, cooperative, association, bank, insurance company, or other legal entity) to the extent that the laws or constituent documents of the other entity permit the merger. A Texas LLC can merge with, or convert into, a Delaware LLC.
- The merger must be pursuant to a written plan of merger containing certain provisions, and the entities involved must approve the merger by the vote required by their respective governing laws and organization documents.
- Under the TBOC, a merger is effective when the entities file an appropriate certificate of merger with the secretary of state, unless the plan of merger provides for delayed effectiveness.
- Unless the company agreement provides them, there are no appraisal rights afforded to dissenters under the TBOC in an LLC merger.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Business combinations—Texas

- An LLC's merger with another entity must be approved by a majority of the LLC's members and there are no appraisal rights afforded to dissenting members, unless its certificate of formation or company agreement specifies otherwise. See "EGAN ON ENTITIES" § 5.5.1 (537-538).
- The TBOC also authorizes an LLC to convert into another form of entity, or convert from another form of entity into an LLC, without going through a merger or transfer of assets, and has provisions relating to the mechanics of the adoption of a plan of conversion, owner approval, filings with the secretary of state, and the protection of creditors. See "EGAN ON ENTITIES" § 1.4.4 (37-39).
- The TBOC provides generally that LLC interests are assignable (subject to reasonable company agreement transfer restrictions), which permits LLC interest purchase transactions comparable to stock purchase transactions in corporations. See "EGAN ON ENTITIES" § 5.11 (562-563).



# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Business combinations—Texas

- The company agreement would typically contain restrictions on the assignment of interests to facilitate compliance with applicable securities and tax laws. Membership interest transfer restrictions contained in the company agreement are generally enforceable.
- The TBOC allows the company agreement to provide whether, or to what extent, member approval of sales of all or substantially all the LLC's assets is required. In the absence of a company agreement provision, the default under the TBOC is to require member approval for the sale of all or substantially all the assets of an LLC.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Divisive merger under TBOC

- Under TBOC §§ 1.002(55)(A) and 10.001-10.008, a corporation, partnership, or LLC can merge with itself creating two or more surviving entities (a plan of merger can divide assets and liabilities among parties, but may not prejudice the rights of existing creditors and is subject to creditors' rights statutes restricting fraudulent transfers). See "*EGAN ON ENTITIES*" § 1.4.3 (29-37).
- TBOC § 1.002(55) defines "merger" to include "(A) the division of a domestic entity into two or more new domestic entities or other organizations or into a surviving domestic entity and one or more new domestic or foreign entities or non-code organizations." A divisive merger under the TBOC can involve any combination of corporations, partnerships, or LLCs, including professional entities, but all of them would need to be organized under the TBOC or the laws of another state which permits divisive mergers.
- A plan of merger for a divisive merger under the TBOC must provide, among other things, (1) the manner and basis for allocating and vesting the property of the parties and (2) the manner and basis of allocating each liability and obligation of the parties or making adequate provision for the payment and discharge thereof. Additionally, the plan of merger should specifically set forth the mechanism under which contingent assets and contingent liabilities of the parties are to be allocated and satisfied or provided for.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Divisive merger under TBOC

- Expressly providing for the allocation and vesting of assets and liabilities will be an important aspect of the plan of merger, as TBOC § 10.008(a) generally provides that, if properly allocated in the plan, all assets and liabilities of the parties to the merger will be allocated (subject to existing contracts, liens, and encumbrances) among the surviving entities in the manner provided in the plan of merger, and not to any other party. If, however, the plan of merger fails to provide for the allocation, or vesting of any particular item of property, or any liability or obligation of any party to the merger, TBOC § 10.008(b) provides that “the unallocated property is owned in undivided interest by, or the liability or obligation is the joint and several liability and obligation of, each of the surviving and new organizations, pro rata to the total number of surviving and new organizations resulting from the merger.”

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Divisive merger under TBOC

- TBOC § 10.008(a) provides when a merger takes effect upon the filing of a certificate of merger with the secretary of state, the separate existence of the constituent entities ceases, and all assets and liabilities of the constituent entities are vested in the surviving entity without “any transfer or assignment having occurred.” This means that all assets of constituent entities move in accordance with the plan of merger, but under TBOC, a merger is not an “assignment” for purposes of provisions in contracts prohibiting assignment unless
  - 1) the contract is an IP license (see *Cincom Systems, Inc. v. Novelis Corp.*, 581 F.3d 431 (6<sup>th</sup> Cir. 1009) discussed in note 15 on p 10 of *Acquisition Structure* paper), or
  - 2) the contract provides that a merger is deemed to be an assignment or otherwise prohibits the merger. See note 13 on page 9 of *Acquisition Structure* paper regarding the *Mezo Scale* case in Delaware, holding that a reverse triangular merger is not an assignment under certain contract provisions.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Business combinations—Delaware

- A Delaware LLC may merge or consolidate with a Delaware or foreign LLC, corporation, statutory trust, general or limited partnership, or “other business entity,” subject to the provisions of its LLC agreement, under DLLCA § 18-209. See “*EGAN ON ENTITIES*” § 5.5.2 (539-544).
- To effect a merger, the LLC should adopt a plan of merger setting forth the terms and conditions of the merger and, after it has been approved by its managers and members as required in its LLC agreement (or in the absence of a governing LLC agreement provision, by the holders of more than 50% of its member percentage interests), file a certificate of merger with the Delaware Secretary of State. Unlike a corporation, there are no Delaware statutory appraisal rights in an LLC merger. DLLCA § 18-210.
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# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Business combinations—Delaware

- Any requirements for member approval of a sale of all or substantially all the assets of a Delaware LLC are left to the LLC agreement. See "*EGAN ON ENTITIES*" § 5.5.2 (539-544)
- Under DLLCA § 18-214, a domestic or foreign corporation, partnership or other entity, or a foreign LLC, may convert into a Delaware LLC by following the procedures specified therein.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Delaware division

- DLLCA § 18-217 enacted effective Aug. 1, 2018, enables a Delaware LLC to divide into two or more LLCs, with the dividing company either continuing its existence or terminating as part of the Delaware division. Section 17-220 of the Delaware Limited Partnership Act permits a similar division of a limited partnership. Delaware does not permit a division of a corporation. See "*EGAN ON ENTITIES*" § 5.5.2 (543-544).
- A Delaware division is effected under DLLCA § 18-217 by (i) the adoption of a plan of division setting forth the terms and conditions of the division, including, among others, the allocation of assets, property, rights, series, debts, liabilities and duties of the LLC being divided among the resulting LLCs and, if it survives, the dividing LLC and (ii) the filing with the Delaware Secretary of State of a certificate of division and a certificate of formation for each newly formed LLC. A plan of division under DLLCA § 18-217 must provide (i) how are interests treated (exchanged or converted into cash, property, rights or securities of, or interests in, the surviving LLC or any resulting LLC, or which interests remain outstanding); (ii) whether the dividing company is surviving; (iii) the names of resulting LLCs; (iv) the allocation of assets, property, rights, debts, liabilities among the surviving LLCs; (v) the name and business address of contact person (the "division contact") that has and will provide upon request a copy of the plan of division.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Delaware division

- A Delaware division must be approved as provided in the LLC agreement of the dividing LLC or, if it is not specifically addressed and not prohibited therein, the Delaware division should be approved in same manner as for a merger or consolidation under the LLC agreement; if the LLC agreement is silent, the Delaware division must be approved by members who own more than 50% of the then current percentage or other interest in the profits of the dividing LLC. The fiduciary duties of managers and members of a dividing LLC are comparable to those applicable to a merger.
- The certificate of division to be filed with the Delaware Secretary of State for a Delaware division must contain: (i) name of the dividing LLC and whether it survives; (ii) the date of filing of the dividing LLC's original certificate of formation; (iii) the name of each division LLC; (iv) the name and business address of the division contact who may be contacted for information about the Delaware division for six years; (v) the effective date of the Delaware division; (vi) that the Delaware Division has been approved in accordance with DLLCA § 18-217; (vii) a statement that the plan of division is on file in the offices of a specified constituent entity and its address; and (viii) the certificate of formation for each resulting LLC.
- A certificate of division may change information in the certificate of formation, including the name or business address of the division contact.



# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Delaware division

- DLLCA § 18-217(l)(2) provides that
  - (i) for all purposes of the laws of Delaware, all of the rights, privileges and powers, and all the property, real, personal, and mixed, of the dividing LLC and all debts due on whatever account to it, as well as all other things and other causes of action belonging to it, shall without further action be allocated to and vested in the applicable division LLC in such a manner and basis and with such effect as is specified in the plan of division, and the title to any real property or interest therein allocated to and vested in any division LLC shall not revert or be in any way impaired by reason of the division, and
  - (ii) if debts and liabilities are not allocated by the plan, they shall be the joint and several debts and liabilities of all of the division LLCs. DLLCA § 18-217 expressly provides that the interest in the property of the LLC as a result of the Delaware division shall not be deemed to have been assigned or transferred.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Indemnification—Texas

- A Texas LLC may (but is not required to) indemnify any of its members, managers, officers, or other persons subject only to such standards and restrictions, if any, as may be set forth in the LLC's certificate of formation or company agreement.
- The restrictions on indemnification applicable to Texas for-profit corporations are not applicable to Texas LLCs.
- This statutory approach increases the importance of having long form indemnification (see sample long-form indemnification provision in "*EGAN ON ENTITIES*" § 5.6 (544-549) because a "to maximum extent permitted by law" provision may encompass things neither the drafter nor the client foresaw, which could lead courts to read in public policy limits or find the provision void for vagueness. The indemnification provisions should specify who is entitled to be indemnified for what and under what circumstances, which requires both thought and careful drafting.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Indemnification—Texas

- TBOC § 8.003 was amended effective September 1, 2021 to specify that provisions restricting the circumstances in which a Texas enterprise must or may indemnify or may advance expenses under TBOC Chapter 8 can be contained in any governing document of the enterprise, as opposed to only the certificate of formation.
- The TBOC was amended effective September 1, 2021 to add a new section 8.005 to provide that the “express negligence” doctrine does not apply to governing documents, which means that LLC indemnification provisions in certificates of formation and company agreements do not have to be in bold face language or italics to meet the express negligence doctrine’s requirement that extraordinary risk shifting provisions must be conspicuous. See “*EGAN ON ENTITIES*” § 2.11.7 (445-447).

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Indemnification—Delaware

- The DLLCA provides that a Delaware LLC has broad power to indemnify and advance costs of defense to its members, managers, and others, and leaves it to the LLC agreement.
- A Delaware LLC is thus far not subject to the same statutory and public policy constraints as are applicable to a Delaware corporation.
- Thus, as in Texas, it is incumbent on those drafting LLC agreements to define therein what, if any, indemnification rights are to be granted by the Delaware LLC.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Capital contributions

- In both Texas and Delaware, the capital contribution of a member may consist of any tangible or intangible benefit to the LLC or other property of any kind or nature, including a promissory note, services performed, a contract for services to be performed or other interests in or securities or other obligations of any other LLC or other entity. The company agreement in Texas, or LLC agreement in Delaware, ordinarily would contain provisions relative to when and under what circumstances capital contributions are required, capital accounts, and the allocation of profits and losses comparable to those in a limited partnership agreement.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Allocations of profits and losses: distributions

- In both Texas and Delaware, allocations of profits and losses, and distributions of cash or other assets, of an LLC are made to the members in the manner provided by the company or LLC agreement.
- A member is not entitled to receive distributions from an LLC prior to its winding up unless specified in the company agreement, which is comparable to how such matters are addressed in a limited partnership agreement.
- An LLC may not make a distribution to its members to the extent that, immediately after giving effect to the distribution, all liabilities of the LLC, other than liabilities to members with respect to their interests and non-recourse liabilities, exceed the fair value of the LLC assets. The determination of value may be made on the basis of the LLC's financial statements, a fair valuation or information from any other method that is reasonable under the circumstances. A member who receives a distribution that is not permitted under the preceding sentence has no liability to return the distribution unless the member knew that the distribution was prohibited. The limitations on distributions by an LLC do not apply to payments for reasonable compensation for past or present services or reasonable payments made in the ordinary course of business under a bona fide retirement or other benefits program.

# Owner Liability for Entity Obligations— “Piercing the Corporate Veil”

## LLC

See “*EGAN ON ENTITIES*” § 5.9 (552-557)

- Legislative history of Texas LLC statute:
  - Article 4.03. Liability to Third Parties. This article provides, except as provided in the regulations, that a member or manager is not liable to third parties, expresses the legislative intent that limited liability be recognized in other jurisdictions and states a member is not a proper party to a proceeding by or against a limited liability company.
- Because a few cases suggested that corporate veil-piercing concepts apply to LLCs, TBOC § 101.002 was amended to provide that the TBOC veil-piercing limitations for corporations also apply to LLCs if veil piercing were otherwise permitted.

# Owner Liability for Entity Obligations— “Piercing the Corporate Veil”

## LLC

See “EGAN ON ENTITIES” § 5.9 (552-557)

- The TBOC provides that, except as provided in the company agreement, a member or manager is not liable to third parties for the debts, obligations, or liabilities of an LLC, although members are liable for the amount of any contributions they agreed in writing to make. Members may participate in the management of the LLC without forfeiting this liability shield, but may be liable for their own torts.
- TBOC § 101.002 (Applicability of Other Laws) provides that TBOC §§ 21.223 (Liability for Obligations), 21.224 (Preemption of Liability), 21.225 (Exceptions to Limitations) and 21.226 (Liability for Obligations) in respect of for-profit corporations apply to an LLC and its members, owners, assignees and subscribers, subject to the limitations contained in TBOC § 101.114 (Liability for Obligations). These TBOC provisions and related corporate case law mean that in Texas, veil piercing should not be applicable except in the case of actual fraud. See “EGAN ON ENTITIES” § 2.4 (100-108). On June 23, 2023 the Texas Supreme Court in *In re First Reserve Management, LP* (No. 22-0227) held that a for-profit corporation was not liable for the torts of a controlled affiliate merely because it appointed directors and monitored its affairs.
- Alter ego veil piercing principles similar to those applicable to Delaware corporations are applicable to Delaware LLCs, with the plaintiff having to demonstrate a misuse of the LLC form along with an overall element of injustice or unfairness.



# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Nature and classes of membership interests

See "*EGAN ON ENTITIES*" § 5.10 (557-563)

- A membership interest in an LLC is personal property. It does not confer upon the member any interest in specific LLC property. A membership interest may be evidenced by a certificate if the company agreement so provides. Subscription for a limited liability company interest may be irrevocable if the subscription states it is irrevocable to the extent provided by the terms of the subscription.
- The company agreement may establish classes of members having expressed relative rights, powers, and duties, including voting rights, and may establish requirements regarding the voting procedures and requirements for any actions including the election of managers and amendment of the certificate of formation and company agreement. The company agreement could provide for different classes of members, each authorized to elect a specified number or percentage of the managers.
- Whether an LLC membership interest is considered a "security" for the purposes of the Securities Act of 1933, as amended, and state securities or Blue Sky laws turns on the rights of the members as set forth in the company agreement and other governing documents and the ability of the investor to exercise meaningful control over his investment.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Winding up and termination

See "*EGAN ON ENTITIES*" § 5.12 (564-572)

The TBOC requires that an LLC commence winding up its affairs, and the LLC Act provided that an LLC is dissolved, upon the occurrence of any of the following events:

- 1) the expiration of the period (if any) fixed for its duration, which may be perpetual;
- 2) the action of the members to dissolve the LLC (in the absence of a specific provision in its certificate of formation or company agreement, the vote will be by a majority of the members);
- 3) any event specified in its certificate of formation or company agreement to cause dissolution, or to require the winding up or termination of the LLC;

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Winding up and termination

- 4) the occurrence of any event that terminates the continued membership of the last remaining member of the LLC, absent certain circumstances; or
- 5) entry of decree of judicial dissolution under the Tex. LLC Stats.
- Under the TBOC, the bankruptcy of a member does not dissolve an LLC, or require its winding up or termination, unless its certificate of formation or company agreement so provides. In Delaware, however, the bankruptcy of a member dissolves the LLC unless its LLC agreement otherwise provides.
- The DLLCA dissolution provisions (DLLCA §§ 18.801 et seq.) are comparable to the TBOC provisions.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Foreign LLCs

See "*EGAN ON ENTITIES*" § 5.13 (573-574)

- Both the TBOC and the DLLCA provide a mechanism by which a limited liability company formed under the laws of another jurisdiction can qualify to do business in Texas or Delaware, as the case may be, as a foreign limited liability company (a "Foreign LLC") and thereby achieve the limited liability afforded to a domestic LLC.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Series LLC

See "*EGAN ON ENTITIES*" § 5.12 (564-572)

- Subchapter M of TBOC Chapter 101 and DLLCA § 18-215 permit the formation of series LLCs which may establish series of members, managers, membership interests, or assets to which different assets and liabilities may be allocated. The Texas series LLC provisions are modeled after the series LLC provisions in Delaware.
- Through appropriate provisions in the company or LLC agreement and certificate of formation, the assets of one series can be isolated from the liabilities attributable to a different series. These provisions allow considerable flexibility in structuring LLCs. The provisions of Subchapter M generally have concepts similar to the Delaware provisions, but in many instances the wording has been revised to conform to the other provisions of the TBOC governing LLCs, including, in particular, the provisions relating to winding-up and termination of the series.
- Effective June 1, 2022, Subchapter M was amended to follow Delaware to allow a company agreement to create a "protected series" and a "registered series," which differ principally in that the "registered series" requires a public filing with the secretary of state of Texas, which intended to facilitate financing transactions by providing public information regarding the series and providing a specified place for its filing of UCC financing statements. If a series does not file a certificate of registration with the secretary of state, it is a "protected series," which will be the case for existing series LLCs.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Series LLC

- To form a series LLC, the organizer must file a certificate of formation that expressly states that the entity is a series LLC and contains a statement that the debts and liabilities of a series are of the series only and are enforceable only against the assets of that series to the extent that the records of the series account for its assets separately from the LLC or another series; provided that an LLC can enforce the debts and liabilities of the series against the company generally or another series if there is an express agreement to do so within the company agreement or other written agreement. The series LLC's company or LLC agreement should also expressly state that the debts and liabilities of a series are of the series only and are enforceable only against the assets of that series and not any other series or the series LLC.
- The records maintained for the series LLC and each series must account separately for the assets of the series LLC and each series.

# Limited Liability Companies

## ["EGAN ON ENTITIES" Chapter 5]

### Series LLC

- A series of a series LLC is not a separate entity under the TBOC or the DLLCA, but is a "person." Although a series is not a separate entity, a series may grant security interests in its assets and file Uniform Commercial Code financing statements in the name of the series rather than that of the series LLC.
- In Texas, each LLC series will have to file an assumed name certificate if it will have a name different from the LLC, as will usually be the case.

# Byron F. Egan

**Practice:** Byron F. Egan is a partner of *Jackson Walker LLP* in Dallas. He is engaged in a corporate, limited liability company, partnership, securities, mergers and acquisitions (M&A), and financing practice. Mr. Egan has extensive experience in business entity formation and governance matters, M&A, and financing transactions in a variety of industries including energy, finance, and technology. In addition to handling transactions, he advises boards of directors and their audits, compensation, and special committees with respect to fiduciary duty and other corporate governance issues, the Sarbanes-Oxley Act, special investigation, and other issues.

**Involvement:** Mr. Egan is senior vice chair and chair of the Executive Council of the M&A Committee of the American Bar Association and served as co-chair of its Asset Acquisition Agreement Task Force, which wrote the *Model Asset Purchase agreement with Commentary*. He has been chair of the Texas Business Law Foundation, the Business Law Section of the State Bar of Texas and that section's Corporation Law Committee. On behalf of these groups, he has been instrumental in the drafting and enactment of many Texas business entity and other statutes. He is also a member of the American Law Institute.

**Honors:** For more than 25 years, Mr. Egan has been listed in "The Best Lawyers in America" under corporate, M&A, or securities law. He is a 2018 recipient of the Texas Lawyer Lifetime Achievement Award, a 2018 recipient of the Distinguished Alumni Award of the Highland Park Independent School District, and the 2015 recipient of the Texas Bar Foundation's Dan Rugeley Price Memorial Award, which is presented annually to a lawyer who has an unreserved commitment to clients and to the legal profession. A four-time winner of the Burton Award for distinguished legal writing, in 2009 his article, "Director Duties: Process and Proof," was awarded the Franklin Jones Outstanding CLE Article Award and an earlier version of that article was honored by the State Bar Corporate Counsel Section's Award for the Most Requested Article in the Last Five Years. Mr. Egan has been recognized as one of the top corporate and M&A lawyers in Texas by a number of publications, including *Corporate Counsel Magazine*, *Texas Lawyer*, *Texas Monthly*, *The M&A Journal* (which profiled him in 2005) and *Who's Who Legal*. See [jw.com](http://jw.com) for additional information regarding his civic and other activities.

**Education:** Mr. Egan received his B.A. and J.D. degrees from the University of Texas. After law school, he served as a law clerk for Judge Irving L. Goldberg on the United States Court of Appeals for the Fifth Circuit.



# Byron F. Egan

**Publications:** Mr. Egan writes and speaks about the areas in which his law practice is focused, and is a frequent author and lecturer regarding M&A, governance of corporations, partnerships and limited liability companies, securities laws, and financing techniques. He is the author of the treatise “*EGAN ON ENTITIES: Corporations, Partnerships and Limited Liability Companies in Texas* (4<sup>th</sup> Edition, 2023),” which addresses the formation, governance, and sale of business entities, including an analysis of the fiduciary duties of their governing persons in a variety of situations. In addition, Mr. Egan has written or co-authored the following law journal articles: *Corporate Governance: Delaware Supreme Court Holds Directors’ Fiduciary Duties Require Monitoring Mission-Critical Risks or What’s the Scoop? Bluebell Shareholder Serves Caremark Claim to Board of Directors*, XXXVII Corporate Counsel Review 271 (November 2019); *Fiduciary Duties of Corporate Directors and Officers in Texas*, 43 Texas Journal of Business Law 45 (Spring 2009); *Responsibilities of Officers and Directors under Texas and Delaware Law*, XXVI Corporate Counsel Review 1 (May 2007); *Entity Choice and Formation: Joint Venture Formation*, 44 Texas Journal of Business Law 129 (2012); *Choice of Entity Decision Tree After Margin Tax and Texas Business Organizations Code*, 42 Texas Journal of Business Law 171 (Spring 2007); *Choice of Entity Alternatives*, 39 Texas Journal of Business Law 379 (Winter 2004); *Choice of State of Incorporation – Texas Versus Delaware: Is it Now Time to Rethink Traditional Notions*, 54 SMU Law Review 249 (Winter 2001); *M&A: Indemnification Arrangements in Business Combinations*, ch. 37 (February 2023) for *Kluwer Treatise on International Business Transactions: Standard Forms and Documents; Express Negligence and Fair Notice Limitations on Risk-Shifting in M&A Transactions*, The Texas Lawbook (May 2021); *Non-Disclosure Agreements and Letters of Intent*, Deal Points (ABA M&A Committee Newsletter) (March 2021); *Earnouts in M&A Transactions*, XXXIX Corporate Counsel Review (November 2020); *Confidentiality Agreements are Contracts with Long Teeth*, 46 Texas Journal of Business Law 1 (Fall 2014); *Private Company Acquisitions: A Mock Negotiation*, 116 Penn St. L. Rev. 743 (2012); *Asset Acquisitions: Assuming and Avoiding Liabilities*, 116 Penn St. L. Rev. 913 (2012); *Asset Acquisitions: A Colloquy*, X U. Miami Business Law Review 145 (Winter/Spring 2002); *Securities Law: Major Themes of the Sarbanes-Oxley Act*, 42 Texas Journal of Business Law 339 (Winter 2008); *Communicating with Auditors After the Sarbanes-Oxley Act*, 41 Texas Journal of Business Law 131 (Fall 2005); *The Sarbanes-Oxley Act and Its Expanding Reach*, 40 Texas Journal of Business Law 305 (Winter 2005); *Congress Takes Action: The Sarbanes-Oxley Act*, XXII Corporate Counsel Review 1 (May 2003); and *Legislation: Texas Chancery Courts – The Missing Link to More Texas Entities*, Texas Bar Journal, Opinion Section, February 2016 Issue; *The Role of the Business Law Section and the Texas Business Law Foundation in the Development of Texas Business Law*, 41 Texas Journal of Business Law 41 (Spring 2005).

# Byron F. Egan – Publications

- Treatise by Byron F. Egan “*EGAN ON ENTITIES: Corporations, Partnerships and Limited Liability Companies in Texas*” (Fourth Edition 2023, “**EGAN ON ENTITIES**”). The Fourth Edition is available from CSC and LexisNexis: <https://blog.cscglobal.com/the-fourth-edition-of-egan-on-entities-captures-recent-legislative-changes-to-offer-in-depth-analysis-of-texas-entities/>
- “M&A After the Tax Reform Act,” Texas Bar CLE and Business Law Section of State Bar of Texas: Choice, Governance & Acquisition of Entities Course, May 18, 2018 (“**Acquisition Structure paper**”): [jw.com/wp-content/uploads/2018/09/Byron-Egan\\_MA-After-Tax-Reform-Act-with-Appendices-Choice-Governance-Acquisition-of-Entities.pdf](http://jw.com/wp-content/uploads/2018/09/Byron-Egan_MA-After-Tax-Reform-Act-with-Appendices-Choice-Governance-Acquisition-of-Entities.pdf)
- “Joint Venture Governance and Co-Ownership agreements,” Texas Bar CLE and Business Law Section: Choice, Government & Acquisitions of Entities Course, May 22, 2020 (“**Joint Venture paper**”): [jw.com/wp-content/uploads/2020/04/25593910\\_1\\_JOINT-VENTURE-GOVERNANCE-AND-CO-OWNERSHIP-AGREEMENTS\\_CHOICE-GOVERNANCE-ACQUISITION-OF-ENTITIES-CLE-PROGRAM-MAY-22-2020.pdf](http://jw.com/wp-content/uploads/2020/04/25593910_1_JOINT-VENTURE-GOVERNANCE-AND-CO-OWNERSHIP-AGREEMENTS_CHOICE-GOVERNANCE-ACQUISITION-OF-ENTITIES-CLE-PROGRAM-MAY-22-2020.pdf)