THE LLC VERSUS LLP CONUNDRUM: ADVICE FOR BUSINESSES CONTEMPLATING THE CHOICE

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I. INTRODUCTION

In recent years the number of unincorporated entities offering limited liability and partnership taxation has increased substantially.[1] Among the newer choices, limited liability companies ("LLCs") arrived on the scene first, with limited liability partnerships ("LLPs") appearing a few years later as a serious challenge to the LLC's domain.[2] Alabama offers businesses the

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1. Unincorporated business organizations in Alabama include sole proprietorships, general partnerships, limited liability partnerships, limited partnerships, and limited liability companies. Corporations that have properly elected subchapter S status are taxed as pass-through entities but face many restrictions not applicable to partnerships. The restrictions faced by S corporations cause many businesses to choose one of the many unincorporated business forms taxed under the partnership provisions. *See* Walter D. Schwidetzky, *Is It Time to Give the S Corporation a Proper Burial?*, 15 VA. TAX REV. 591, 624 (1996). A comparison of the complex business and tax differences between S corporations and unincorporated businesses taxed as partnerships is beyond the scope of this Article. *See also* ALA. CODE § 10-8A-101(5) (Supp. 1998) (defining a partnership under Alabama law); *id.* § 10-8A-1001 (listing the requirements for registering as a registered limited liability partnership); *id.* § 10-9B-101(9) (defining limited partnership under Alabama law); *id.* §§ 10-12-1 to -61 (1994) (establishing the Alabama limited liability company).

2. *See infra* notes 3-4 and accompanying text.

opportunity to use either a LLC[3] or a LLP,[4] both of which provide the members or partners with the same limited liability protection enjoyed by corporate shareholders.[5] The LLC is a

3. The Alabama LLC Act was passed by the Senate on Apr. 22, 1993. S. 549, 165th Leg., Reg. Sess., 1993 S.J. Ala. 1293-94. The House of Representatives passed the Act on May 17, 1993. H.R. 549, 165th Leg., Reg. Sess., 1993 H.R.J. Ala. 4141-42. On May 17, 1993, both houses signed the bill. 1993 S.J. Ala. 2845-46; 1993 H.R.J. Ala. 4165-66. The Alabama LLC Act became effective on Oct. 1, 1993 after being signed by Governor Jim Folsom on May 20, 1993. 1993 Ala. Acts 1425-60. It is codified at title 10, chapter 12 of the *Code of Alabama*.

4. The LLP was adopted in Alabama with the adoption of the revised Uniform Partnership Act of 1996 (RUPA) by Act No. 96-528. The House of Representatives passed RUPA on March 5, 1996. H.R. 184, 168th Leg., Reg. Sess., 1996 H.R.J. Ala. 624-25. The Senate passed RUPA on May 9, 1996. S. 184, 168th Leg., Reg. Sess., S.J. Ala. 2341-43. Both houses signed the bill on May 9, 1996. 1996 H.R.J. Ala. 3425; 1996 S.J. Ala. 2448-49. Alabama's version of RUPA, with an effective date of Jan. 1, 1997, was signed by Governor Fob James on May 17, 1996. 1996 ALA. ACTS 685-738. It is codified at title 10, chapter 8A of the *Code of Alabama*. For broad identification purposes, all references to RUPA in this Article will be to RUPA section numbers rather than to the comparable Alabama statute. For an analysis of the differences between RUPA and the version passed by Alabama, see General Statutory Note, 6 U.L.A. 7 (Supp. 1998).

5. *See* RUPA § 306(c) (1996). The statutory language states:

> [A] partner in a registered limited liability partnership is not personally liable or accountable, directly or indirectly (including by way of indemnification, contribution, assessment or otherwise), for debts, obligations and liabilities of, or chargeable to, the registered limited liability partnership, or another partner or partners, whether arising in tort, contract or otherwise, solely by reason of being such a partner. . . .

Id.; ALA. CODE § 10-12-20 (1994). The statutory language states: "a member of a limited liability company is not liable . . . for a debt, obligation, or liability of the limited liability company, whether arising in contract, tort, or otherwise, or for the acts or omissions of any other member, manager, agent, or employee of the limited liability company." *Id.* § 10-2B-6.22. The statutory language states: "[n]either a subscriber nor a shareholder of a corporation is personally liable for the acts or debts of the corporation." *Id.*; *see also* 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES § 1.04 (1996) (stating that the presence of limited liability protection will not shield a partner, member, or shareholder from personal liability for their own negligent acts).

Like shareholders of corporations, both LLC and LLP owners should be subject to the veil-piercing doctrine applicable to corporate shareholders because no valid policy exists that supports treating LLCs and LLPs differently than corporations for purposes of veil piercing. *See* Debra Cohen-Whelan, *Individual Responsibility in the Wake of Limited Liability*, 32 U.S.F. L. REV. 335, 348 (1998) (stating that "[t]he corporate veil-piercing doctrine will sometimes apply to LLCs because of their chameleon-like nature"); Carol J. Miller, *LLPs: How Limited Is Limited Liability?*, 53 J. MO. B. 154, 159 (1997) (citing MINN. STAT. ANN. § 323.14.3 (1994) in arguing that "LLP partnerships should be subject to piercing the veil arguments under 'conditions and circumstances under which the corporate veil' might be pierced"). Alabama, statutorily created new business form initially invented by independent oil and gas explorers and later supported by a wide variety of business activities.[6] Wyoming enacted the first statute in 1977,[7] and more than ten years later, in 1988, the Internal Revenue Service finally recognized the LLC's ability to be taxed like a partnership.[8] By 1996 all fifty states had passed legislation authorizing LLCs.[9]

The LLP is a general partnership that has registered to provide all partners with limited liability protection.[10] Texas enacted the first LLP statute in 1991 as a response to astronomical losses threatening lawyers and accountants as a result of their partners' involvement in the savings and loan crises of the

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unlike some states, does not explicitly mention the corporate veil-piercing doctrine in its LLC or LLP statutes. *See* Cohen-Whelan, *supra*, at 351-52 (discussing the inclusion of the veil-piercing doctrine in some state LLC legislation). The Alabama Supreme Court has, however, given a list of the factors relevant in piercing the corporate veil. Simmons v. Clark Equip. Credit Corp., 554 So. 2d 398, 401 (Ala. 1989). Specifically, it stated:

> The corporate veil may be pierced where a corporation is set up as a subterfuge, where shareholders do not observe the corporate form, where the legal requirements of corporate law are not complied with, where the corporation maintains no corporate records, where the corporation maintains no corporate bank account, where the corporation has no employees, where corporate and personal funds are intermingled and corporate funds are used for personal purposes, or where an individual drains funds from the corporation.

Simmons, 554 So. 2d at 401. The corporate veil may also be pierced "in the absence of fraud, to prevent injustice or inequitable consequences." Barrett v. Odom, 453 So. 2d 729, 732 (Ala. 1984) (citing Cohen v. Williams, 318 So. 2d 279 (1975)).

6. For a complete outline of the chain of events leading to the LLC's birth and subsequent rise, along with a broader historical analysis, see Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459 (1998).

7. Act of Mar. 4, 1977, ch. 158, 1977 Wyo. Sess. Laws 512.

8. Rev. Rul. 88-76, 1988-2 C.B. 360; *see* Susan Pace Hamill, *The Limited Liability Company: A Possible Choice for Doing Business*, 41 U. FLA. L. REV. 721 (1989) (an early article predicting the LLC's popularity); Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375 (1992) (discussing early business and tax problems that confronted the LLC).

9. *See* Susan Pace Hamill, *The Limited Liability Company: A Catalyst Exposing the Corporate Integration Question*, 95 MICH. L. REV. 393 (1996) (concluding that the creation and proliferation of LLCs was completely tax driven and providing extensive statistical and legal analysis showing that the LLC imposes no material threat to corporate tax revenues); *see also id.* at 400 n.28, 402 n.45, 403-04 nn.48-49 & 51-52 (documenting LLC statutes by year). Although this Article cites RUPA in reference to LLPs, the Article will cite the LLC statutes adopted by the State of Alabama because of the lack of uniformity among the states in adopting the Uniform Limited Liability Company Act (ULLCA).

10. RUPA § 1001 (providing for registration with the probate judge).

late 1980s.[11] Subsequently, the number of states authorizing LLP registration in their general partnership statutes grew rapidly, and by 1999 all fifty states and the District of Columbia had enacted statutes authorizing LLP registration.[12]

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11. Act of Aug. 26, 1991, § 84, 1991 Tex. Sess. Law Serv. 901 (West) (codified at TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (West Supp. 1995)); Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065, 1069 (1995). The LLP as created by the Texas legislature, however, only protected partners from personal liability when the losses resulted from the malpractice of another partner. All partners remained personally liable for partnership losses related to general business debts and torts unrelated to malpractice. Hamilton, *supra*, at 1067. Soon after the enactment of the LLP in Texas, other state legislatures passed statutes allowing businesses operating as general partnerships to register as LLPs, and eventually the states started to offer LLP partners the full limited liability protection enjoyed by corporate shareholders and LLC members and managers. The partners enjoy full limited liability protection and, therefore, are not personally liable for any of the partnership obligations, whether they arise in tort or contract. *Id.* at 1066-67. When Alabama adopted RUPA in 1996, it included LLP registration providing the same limited liability protection enjoyed by members of Alabama LLCs and shareholders of Alabama corporations. ALA. CODE §§ 10-8A-306(c), -1001 (Supp. 1998). Despite the narrow interest group motivations behind its creation, the LLP has quickly evolved into a popular business form used by many different kinds of businesses, far removed from law firm partners who fear draconian personal liability for the malpractice of their partners.

12. ALA. CODE § 10-8A-1001 (Supp. 1998); ALASKA STAT. § 32.05.415 (Michie 1998); ARIZ. REV. STAT. ANN. § 29-244 (West 1998); ARK. CODE ANN. § 4-42-703 (Michie Supp. 1997); CAL. CORP. CODE § 2.8.15049 (West Supp. 1999); COLO. REV. STAT. ANN. § 7-64-1002 (West 1998); CONN. GEN. STAT. ANN. § 34-419 (West 1997); DEL. CODE ANN. tit. 6, § 1544 (Supp. 1998); D.C. CODE ANN. § 41-160.1 (1998); FLA. STAT. ANN. § 620.78 (West Supp. 1997); GA. CODE ANN. § 14-8-62 (Supp. 1998); HAW. REV. STAT. ANN. § 425-153 (Michie Supp. 1998); IDAHO CODE § 53-343A (Supp. 1998); 805 ILL. COMP. STAT. ANN. 205/8.1 (West Supp. 1998); IND. CODE ANN. § 23-4-1-45 (West Supp. 1998); IOWA CODE ANN. § 486.44 (West Supp. 1998); KAN. STAT. ANN. § 56-345 (Supp. 1998); KY. REV. STAT. ANN. § 362.555 (Michie Supp. 1996); LA. REV. STAT. ANN. § 9:3432 (West 1997); ME. REV. STAT. ANN. tit. 31, § 801 (West Supp. 1998); MD. CODE ANN. CORPS. & ASS'NS § 9A-1001 (Supp. 1998); MASS. GEN. LAWS ANN. ch. 108A, § 45 (West 1998); MICH. COMP. LAWS ANN. § 449.44 (West Supp. 1998); MINN. STAT. ANN. § 323A.10-01 (West Supp. 1999); MISS. CODE ANN. § 79-12-87 (Supp. 1998); MO. ANN. STAT. § 358.440 (West Supp. 1999); MONT. CODE ANN. § 35-10-701 (1995); NEB. REV. STAT. § 67-344 (1996); NEV. REV. STAT. ANN. § 87.440 (Michie 1995); N.H. REV. STAT. ANN. § 304-A:44 (Supp. 1998); N.J. STAT. ANN. § 42:1-44 (West Supp. 1998); N.M. STAT. ANN. § 54-1-44 (Michie 1996); N.Y. PARTNERSHIP LAW § 121-1500 (McKinney Supp. 1999); N.C. GEN. STAT. § 59-84.2 (Supp. 1997); N.D. CENT. CODE § 45-22-03 (Supp. 1997); OHIO REV. CODE ANN. § 1775.61 (Banks-Baldwin Supp. 1998); OKLA. STAT. ANN. tit. 54, § 1-1002 (West Supp. 1999); OR. REV. STAT. § 67.500 (Supp. 1998); PA. STAT. ANN. tit. 15, § 8201 (West 1995); R.I. GEN. LAWS § 7-12-56 (1996); S.C. CODE ANN. § 33-41-1110 (Law Co-op. Supp. 1998); S.D. CODIFIED LAWS § 48-7-108 (Michie Supp. 1998); TENN. CODE ANN. § 61-1-143 (Supp. 1998); TEX. REV. CIV. STAT. ANN. art. 6132b-3.08 (West

The LLC and LLP both derive their essential business characteristics from partnership forms. The LLC represents an entirely new business form in which the members can choose to formally appoint managers, thus creating a manager-managed LLC, which generally operates using a centralized management structure much like a limited partnership.[13] If the members do not appoint managers, the members, due to their statutory powers to bind and manage the LLC, strongly resemble ordinary general partners in a general partnership.[14] The LLP remains first and foremost a general partnership, the oldest and most traditional business organization.[15] By vesting with all partners or members the power to bind their respective entities and participate in the management of the business, both LLPs and member-managed LLCs share a common origin from the Uniform Partnership Act of 1914.[16]

Businesses contemplating a choice between the member-managed LLC and the LLP will find the two business forms very difficult to distinguish. Moreover, despite the limited partnership-based centralized management structure, even manager-managed LLCs can strongly resemble LLPs if the members use the operating agreement to destroy the centralization of management.[17] Unlike limited partners of limited partnerships,[18] the

Supp. 1999); UTAH CODE ANN. § 48-1-42 (1998); VT. STAT. ANN. tit. 11, § 3291 (1998); VA. CODE ANN. § 50-43.1 (Michie 1998); WASH. REV. CODE ANN. § 25.05.500 (West Supp. 1999); W. VA. CODE § 47B-10-1 (1998); WIS. STAT. ANN. § 178.40 (West 1997); WYO. STAT. ANN. § 17-21-1101 (Michie Supp. 1998).

13. *E.g.*, ALA. CODE § 10-12-22 (Supp. 1998). *See generally* Mitchel Hampton Boles & Susan Pace Hamill, *Agency Powers and Fiduciary Duties Under the Alabama Limited Liability Company Act: Suggestions for Future Reform*, 48 ALA. L. REV. 143, 151-53 (1996).

14. ALA. CODE § 10-12-22 (Supp. 1998).

15. RUPA §§ 202, 1001-1010.

16. RUPA § 401(f); ALA. CODE § 10-12-22(a) (Supp. 1998); UNIF. PARTNERSHIP ACT § 9(1), 6 U.L.A. 400-01 (1995) [hereinafter UPA] (codified in ALA. CODE § 10-8-49(a) (1994) (repealed effective Jan. 1, 2001 and replaced by ALA. CODE § 10-8A-301 (Supp. 1998))).

17. ALA CODE § 10-12-24 (Supp. 1998) (explaining that the operating agreement can broadly address any provisions regarding the affairs of the LLC). In order for a manager-managed LLC to substantially resemble a member-managed LLC or a LLP, the non-managers must assume substantial responsibilities related to the business. *See* Boles & Hamill, *supra* note 13, at 157-58 (stating that if non-managing members of manager-managed LLCs take on a "narrowly defined task with no continuity of service," they remain special agents and, therefore, do not destroy the LLC's centralized management structure).

18. Limited partners in a limited partnership are not statutorily vested with the

members of LLCs who are not managers possess complete freedom to acquire, through the operating agreement, an unlimited amount of power to bind and participate in the business affairs of the LLC.[19] If the facts show that non-managing members are participating heavily in the business, that particular manager-managed LLC will, in fact, operate more like member-managed LLCs and LLPs, despite the formal appointment of managers.[20] Only manager-managed LLCs, in which the managers do, in fact, retain most of the management powers thus staying close to the limited partnership model, truly offer a business organization choice that materially differs from the LLP on the broadest

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power to bind the partnership or make business decisions concerning the partnership. Limited partners are, in fact, penalized for attempting to take on too much responsibility in the partnership. If a limited partner gets too heavily involved in the partnership's business, the law deems him to be a general partner, and he loses his limited liability shield. *See* REVISED UNIF. LTD. PARTNERSHIP ACT § 303 (1985), 6A U.L.A. 144 (1995) [hereinafter RULPA].

The limited liability limited partnership ("LLLP") is the newest unincorporated business organization which offers limited liability to all equity owners. States with LLLP statutes allow the general partner, who in the traditional limited partnership bore personal liability for debts of the entity, to enjoy as much liability protection as the limited partners. COLO. REV. STAT. ANN. §§ 7-62-403(2)(a)(II), (2)(b)(II) (1998). Consequently, limited partners of LLLPs should not be concerned about assuming substantial management responsibilities because being deemed a general partner will not cause personal liability exposure.

19. ALA. CODE §§ 10-12-1, -24 (Supp. 1998). Under agency law, at some point, despite the presence of managers, non-managing members of LLCs assuming heavy business responsibilities cross over from special agent to general agent status. Non-managing members of LLCs that have become general agents are indistinguishable from the managers who, by virtue of the LLC statute, automatically possess the broad apparent authority of a general agent. *See* Boles & Hamill, *supra* note 13, at 156-60. Although pinpointing the cross-over point will be difficult, the greater duties assumed by the non-manager combined with a closely held informal operational scheme will increase the non-managing member's chances of being treated like a general agent. *Id.*

20. Boles & Hamill, *supra* note 13, at 151-60. Manager-managed LLCs that operate like member-managed LLCs and LLPs due to the high degree of business participation by the non-managing members come with their own unique business issues regarding the scope of the non-managing member's apparent authority to bind the LLC. Member-managed LLCs, LLPs and traditional manager-managed LLCs can more easily use the general and limited partnership precedents to define the scope of apparent authority. *Id.* at 149, 151-53. However manager-managed LLCs may find it difficult to predict the extent of a non-manager's apparent authority. *Id.* at 154. Once a non-managing member starts assuming business responsibilities, the apparent authority protecting third parties can extend to the entire scope of the LLC's business, remain focused on the business activities assumed, or end up somewhere in between. *Id.* at 158-60.

substantive level.[21]

This Article explores the legal distinctions and business factors that lawyers should weigh when choosing between LLCs and LLPs for their clients. Although LLPs and many LLCs appear to offer the same kind of business organization, both contain a variety of technical differences buried in their respective statutes that may materially affect certain businesses. The combination of these technical differences, the goals of the particular business, and the level of transaction costs available for business planning will cause some businesses to be better off choosing the LLC while others would have better results using the LLP. On a comparative level, Part II of this Article focuses on the legal rules in both the LLC and LLP statutes surrounding the management and fiduciary duty provisions, the dissociation and dissolution provisions, and the economic sharing provisions for allocating profits and losses. Despite the common general partnership roots behind the management and fiduciary duty provisions of LLPs, member-managed LLCs, and many manager-managed LLCs, several technical differences exist between the LLC and LLP statutes. Although most of the technical differences are minor and, therefore, likely to be of no consequence, the LLC's ambiguous voting standards, particularly related to salary payments, may cause some difficulty for businesses using LLCs.[22]

Highlighting the significant technical differences in the LLC and LLP statutes which materially affect a choice between the two forms, Part II also discusses in detail the remaining two substantive areas, dissociation and dissolution and profit and loss sharing. RUPA preserves for the partners of LLPs the absolute power to dissociate by voluntary act, guaranteeing each individual partner some measure of liquidity in the partnership interest.[23] The LLC statute contains no statutory dissociation rights rendering members similar to shareholders of closely held

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21. *See generally* Boles & Hamill, *supra* note 13; ALA. CODE § 10-9B-403 (Supp. 1998) (stating that general partners of limited partnerships have all of the powers of a general partner in a general partnership); ALA. CODE § 10-9B-303 (Supp. 1998) (providing for loss of the limited liability shield for any limited partner who "participates in the control" of the limited partnership business).

22. *See infra* notes 43-49 and accompanying text.

23. RUPA § 602(a).

corporations.[24] Consistent with the general partnership model, LLP partners that fail to agree on profit and loss ratios share profits equally and losses according to the profit ratio.[25] Recognizing the existence of the limited liability shield, the LLP statute stops default loss allocations when the partner's capital account reaches zero.[26] If LLC members fail to agree on profit and loss ratios, the default provision allocates both according to the member's ratio of unreturned capital.[27] Unlike the LLP, which recognizes oral agreements,[28] the LLC statute requires that the operating agreement be in writing.[29] Consequently, LLC members relying on an oral agreement to share profits may end up with a smaller profit share than they bargained for.[30]

Drawing upon the legal distinctions discussed in Part II, Part III analyzes the business factors lawyers should consider when advising clients on whether to organize as a LLC or a LLP. After briefly discussing the business scenarios in which the LLC represents the clear choice, Part III then develops hypothetical business scenarios to analyze whether the LLC or LLP represents the more appropriate form for the many businesses that will not automatically choose the LLC. The businesses finding it most difficult to choose between the LLC and the LLP include professional associations and small, active businesses with a high level of owner participation.

The level of business planning available to the participants and the relative sophistication of the business owners should be the most important concerns when choosing between a LLC or a LLP. If the business transaction will involve a great deal of thought and planning and a detailed operating agreement, both

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24. ALA. CODE § 10-12-30 (Supp. 1998) (denying dissociating LLC members any rights to receive payment for their interest unless the articles of organization or the operating agreement explicitly creates buy/sell provisions). *See generally* Laurel Wheeling Farrar & Susan Pace Hamill, *Dissociation from Alabama Limited Liability Companies in the Post Check-the-Box Era*, 49 ALA. L. REV. 909 (1998).

25. RUPA § 401(b).

26. RUPA § 306(c); *see also infra* notes 97-108 and accompanying text (discussing in detail the mechanics of RUPA's default loss allocations).

27. ALA. CODE § 10-12-28 (1994).

28. RUPA § 101(6) & cmt. 2 (stating that "[t]he partnership agreement need not be written; it may be oral or inferred from the conduct of the parties").

29. ALA. CODE § 10-12-24(b) (Supp. 1998).

30. *See id.*; *see also infra* notes 91-96 and accompanying text.

the LLP and the LLC will equally meet the client's goals. If the business client cannot afford the transaction costs associated with a detailed operating agreement, on the whole, the LLP will better safeguard the participants' goals. Although member-managed LLCs, manager-managed LLCs using a decentralized management structure, and LLPs offer essentially the same type of business organization, if business participants who cannot afford the transaction costs of careful planning choose the LLC, the default provisions may result in negative consequences.

II. LEGAL COMPARISON OF MAJOR STATUTORY PROVISIONS GOVERNING LLCS AND LLPS

A. *Agency Powers, Management and Fiduciary Duties*

Like traditional general partnerships, RUPA deems every partner in a registered LLP to be a general agent of the partnership for the purpose of conducting the partnership's business.[31] Consequently, even if an individual partner has no actual authority to bind the partnership, agency law deems that partner to have apparent authority regarding the entire scope of the partnership's business.[32] Third parties with no notice can rely on that apparent authority even if an internal management agreement denies the partner actual authority.[33] As previously stated, member-managed LLCs vest in all members the same agency powers enjoyed by LLP partners.[34]

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31. RUPA § 301.

32. 1 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON PARTNERSHIP § 4.02 (1998) (discussing RUPA's provisions addressing a partner's ability to bind the partnership).

33. *Id.*

34. *Compare* ALA. CODE § 10-12-21 (Supp. 1998) (describing agency power of members and managers in LLCs), *with* RUPA § 301 (setting out partners' agency powers). RUPA makes two changes to the language of the UPA in the area of partner agency. First, RUPA states that a partner's apparent authority extends beyond the business of the particular partnership in question to acts for "carrying on in the ordinary course . . . business of the kind carried on by the partnership . . . ." RUPA § 301(1). The second difference is the allocation of risk for a partner's acts outside his authority. The UPA states that only parties with knowledge of a restriction on a partner's authority are bound by the restriction. UPA § 9(1), 6 U.L.A. 400-01 (1995).

Despite this seemingly identical treatment accorded LLPs and member-managed LLCs, at least two minor technical differences may impact some businesses. RUPA explicitly provides LLP partners limited options to alert third parties that certain partners have no power to bind the partnership. If the partners properly file a statement of authority specifying which partners have no ability to deal in the partnership's real estate, third parties conclusively are deemed to have constructive notice of this limitation.[35] RUPA also allows for a notification procedure to alert third parties that certain partners have no actual authority to bind the partnership in all other business matters.[36] Unlike the statement of authority, which only requires a central filing to cut off the apparent authority through constructive notice, the notification procedure requires actual communication with the third parties by complying with notification procedures detailed in the statute.[37] RUPA makes it clear that a partner's apparent authority extends to acts for conducting "business of the kind carried on by the partnership" and not just the particular business in which the partnership is involved.[38]

Alabama's LLC statute does not technically provide a mechanism to cut off a member's authority by filing a statement of

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RUPA changes the UPA by allowing parties to be bound by the restriction as long as they have received notification, regardless of whether the party had actual knowledge of the restriction. RUPA § 301 cmt. 2. Notification is effective upon delivery. *Id.*

35. RUPA § 303(e).

36. *Id.* § 301 cmt. 2.

37. *Id.* Even though RUPA's notification procedure does provide the partnership with a method of limiting a partner's authority, the notification procedure may not have much practical impact. The partnership is required to anticipate persons that a partner may attempt to deal with and provide notification of the limitation on authority prior to any attempts by the partner to deal with the third person. *See id.* While it may be relatively easy to provide notification to persons the partnership has dealt with in the past or is currently dealing with, it will be almost impossible to notify all persons a partner could potentially deal with while conducting "business of the kind carried on by the partnership." *Id.* § 301(1).

38. RUPA § 301 cmt. 2. Thus, it is difficult to cut off the authority of a partner in a LLP. The method of limiting the authority of a LLP partner uses the operating agreement to concentrate management power. In large, more complex partnerships the operating agreement typically vests the authority to complete certain tasks with designated committees. Although each partner's apparent authority still protects third parties dealing with partners who are not on the committee, other internal penalties such as expulsion will effectively discourage partners not on the committee from violating the internal management structure.

authority or complying with the notification procedure. The appointment of managers represents the only avenue available to cut off the members' agency powers.[39] Rather than reflecting a major policy distinction between LLPs and member-managed LLCs, this difference can be explained by historical evolution. Alabama's LLC statute was modeled after the UPA,[40] the general partnership statute governing in 1993, which had no provisions allowing statements of authority or notification.[41] RUPA, which became the law in Alabama in 1996, along with the LLP registration alternative, first introduced these opportunities.[42] The difference between the LLC and the LLP likely resulted from oversight rather than intentional design. It would make sense for the Alabama legislature to eliminate the disparity by allowing LLC members the opportunity to file statements of authority or comply with notification procedures.

The voting procedures for making managerial decisions highlight other technical differences between LLCs and LLPs that can cause problems for unsophisticated, informal businesses operating as member-managed LLCs or manager-managed LLCs that have reverted to a decentralized management structure. RUPA specifically states that majority vote carries ordinary decisions in the LLP while decisions "outside the ordinary course of business" must be decided by unanimous vote.[43] Although the line distinguishing ordinary from extraordinary business decisions will not always be clear, RUPA's default provisions mandate that distributions, once declared, follow the partners'

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39. *See* ALA. CODE § 10-12-21(b) (Supp. 1998) (providing that in manager-managed LLC's, membership does not confer agency power).

40. Alabama's LLC statutes were effective in 1993 whereas the UPA was adopted in 1971.

41. *See* RUPA § 303 cmt. 1 (noting that the statement of authority provision was added by RUPA).

42. *Id.*

43. *Id.* § 401(j). Courts have held that extraordinary decisions include "changing the form of the business entity and substantially altering the rights of the parties." 2 BROMBERG & RIBSTEIN, *supra* note 32, at § 6.03(c)(4) (citations omitted); *see also* Thomas v. Marvin E. Jewell & Co., 440 N.W.2d 437 (Neb. 1989) (declaring that unanimous consent was required to change the income distribution formula); Fortugno v. Hudson Manure Co., 144 A.2d 207 (N.J. Super. Ct. App. Div. 1958) (involving a dispute over whether to incorporate a part of the partnership business); Duell v. Hancock, 443 N.Y.S.2d 490 (N.Y. 1981) (discussing voting rights in the context of admission of new partners).

profit sharing ratio,[44] and no partner has the right to receive a salary payment outside the profit sharing ratio.[45] Because any decision to change either of these rules must be agreed to by all partners, the partnership voting standards provide valuable protection to minority partners against freeze-out techniques.[46]

The Alabama LLC Act's provisions addressing management provide no explicit default rules dictating how to count the votes (per capita or economic shares) or the percentage vote required (majority or unanimity) to carry business decisions.[47] Although the commentary to subsections (a) and (b) of section 10-12-22 of the *Code of Alabama* states that votes will be counted on a per capita basis, meaning each member gets one vote, regardless of disparities in their economic sharing arrangement, no language in the statute or comment addresses the number of votes (majority versus unanimity) required for the decision to go forward.[48]

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44. RUPA § 401(b).

45. *Id.* § 401(h).

46. *See id.* (providing that partners are "not entitled to remuneration for services performed for the partnership"); *see also* Cagnolatti v. Guinn, 189 Cal. Rptr. 151, 157 (Cal. Ct. App. 1983) (stating that "the rule is '[a]bsent an express agreement, a partner is not entitled to any compensation for his services to the partnership other than his share of the profits'") (citation omitted); J. WILLIAM CALLISON, PARTNERSHIP LAW & PRACTICE: GENERAL AND LIMITED PARTNERSHIPS § 10.07 ("The general rule against payment of partners in the absence of agreement is based on the concept that partners receive payment for their services through their shares of partnership profits.") (footnote omitted); Franklin A. Gevurtz, *Squeeze-Outs and Freeze-Outs in Limited Liability Companies*, 73 WASH. U. L.Q. 497, 505 (1995) (stating that "[s]ection 18(f) of the UPA precludes partners from receiving salaries from the firm without agreement of all the partners . . . "). The partnership statute does not clearly state whether the decision to make any distributions is ordinary (majority vote) or extraordinary (unanimous). Gevurtz, *supra*, at 504-05. However, once the partners declare distributions, all partners have rights based on their profit percentage. ALA. CODE § 10-8A-401(b) (Supp. 1998). Because partnerships statutorily guarantee all partners the right to dissociate and withdraw their capital, as a practical matter, disputes concerning distributions rarely arise. Gevurtz, *supra*, at 505; *see also infra* notes 69-74 and accompanying text (discussing in detail dissociation from partnerships).

47. ALA. CODE § 10-12-22 (Supp. 1998). Although the amendments to the Alabama LLC statute, effective January 1, 1998, explicitly allow the members to create different classes of interests (which can be based on voting power), the general management rules still fail to set out voting rules when the members do not exercise this option or otherwise address voting in the operating agreement. *Id.* § 10-12-22(c).

48. *Id.* § 10-12-22 cmt. (1994) (stating that the statute "adopts a default per capita rule (because of potential problems of determining capital contributions, particularly in the sort of informal firms that are likely to adopt the default rule)"). The 1998 amendment to section 10-12-22 adds specificity regarding the creation of

Despite the absence of authority in the Alabama statutory language, using RUPA by analogy, businesses operating as LLCs can reasonably infer that ordinary decisions require a majority vote while extraordinary decisions require a unanimous vote. If every routine management decision required unanimity, business would become unreasonably inefficient.[49]

The Alabama statute requires LLC operating agreements (and all subsequent amendments) to be in writing and unanimously approved by all members.[50] Distributions, once declared, must follow the profit percentages unless all the members agree to a different distribution scheme in the operating agreement.[51] While explicitly recognizing the ability of LLC members to deal with the LLC as third parties, which would include an employment relationship and the payment of salaries,[52] the Alabama statute does not explicitly address salaries. If salaries are more properly viewed as a subject for the operating agreement or an extraordinary business decision, all members must authorize the payment.[53] On the other hand, if salaries merely represent an ordinary business decision, arguably a majority of the members can authorize the payment over the

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different classes of members or managers in a LLC and does not affect the default per capita voting rule as described in the original comment. *Id.* § 10-12-22 (Supp. 1998).

49. *See* 2 BROMBERG & RIBSTEIN, *supra* note 32, at § 6.03(c)(2) ("A rule requiring unanimity on all issues would impose substantial costs because of the inevitability of disagreement on many issues.") (footnote omitted); *but see* J. BUCHANAN & G. TULLOCK, THE CALCULUS OF CONSENT 85-96 (1962) (discussing the theory that "the rational individual should always support the requirement of unanimous consent before . . . decisions are finally made" but that a departure from the unanimity rule is rationalized by the introduction of decision-making costs).

50. ALA. CODE § 10-12-24(b) (Supp. 1998).

51. *Id.* § 10-12-29. Although the statute clearly requires unanimity for distributions, once declared, to deviate from the profit percentage, the level of consent required to actually declare distributions remains unclear. If the decision whether to make any distributions at all can be considered an ordinary business decision rather than either an extraordinary decision or a subject for the operating agreement, then a majority can authorize the distribution. *See id.* § 10-12-22 (1994). However all members still must consent to a distribution scheme that varies from the profit percentages. *See supra* note 46.

52. ALA. CODE § 10-12-19 (1994).

53. *See id.* § 10-12-22 (Supp. 1998); *see also supra* note 46 and accompanying text (discussing partnership authorities which clearly state that decisions to authorize salaries require unanimous approval).

objection of other members.[54]

Business ventures that operate using a centralized management structure by definition are organized with more formality and, therefore, will probably address voting standards and salaries explicitly in the operating agreement as part of the governance plan. Thus, the ambiguities in the LLC default provisions related to voting standards and salary payments will rarely cause problems for manager-managed LLCs that adhere to the centralized management plan. However, business participants using LLCs without a carefully tailored governance scheme, which will include many member-managed LLCs and manager-managed LLCs operating with a decentralized structure, will encounter more uncertainty in day-to-day operations than comparable businesses using LLPs.

As long as the number of participants remains relatively small and the relationships remain harmonious, these differences between LLCs and LLPs should not cause any significant problems. However, if the business participants experience a falling out resulting in majority and minority factions, commonly seen in close corporations, the uncertain rules concerning the level of agreement necessary to authorize salary payments will cause significant problems for minority members of LLCs.

As already stated, RUPA's unanimity standards for distributions and salaries protect minority partners of LLPs from freeze-outs,[55] while LLC members only enjoy similar protection from distributions failing to follow the profit percentage.[56] In the common freeze-out fact pattern the majority group authorizes its own salaries while excluding the minority members from similar payment. If payment of salary can be classified as an ordinary business decision, members of LLCs, who enjoy no statutory rights to dissociate and withdraw their capital, will be as vulnerable as close corporation shareholders to freeze-out techniques.[57]

One can argue that salaries to LLC members represent an

54. *Id.*; *see also* Farrar & Hamill, *supra* note 24, at 924; *infra* notes 62 & 63 (discussing corporate authorities which clearly state that decisions to authorize salaries require only majority approval).

55. RUPA § 401(h), (j).

56. *See* ALA. CODE § 10-12-28 (1994).

57. *See infra* notes 79-80 and accompanying text.

important consideration that either must be covered by the operating agreement or at least rise to the level of being an extraordinary business decision. Many LLCs strongly resemble general partnerships covered by RUPA, and RUPA explicitly requires all partners to agree to salary payments.[58] Moreover, LLC operating agreements must be agreed upon unanimously,[59] and distributions varying from the profit percentage must meet the unanimous threshold of the operating agreement.[60]

On the other hand, the LLC statute, unlike RUPA, does not mention salaries, and the LLC distribution provisions address profits only, which would support classifying salary as an ordinary management decision rather than a subject that must appear in the operating agreement. Unless the Alabama legislature amends the LLC statute to deal with the salary question, majority members of LLCs will likely assume that they can validly authorize salaries, forcing the courts to interpret the statute after the minority members experience a freeze-out and sue.

Under their respective statutes, LLP partners and members of member-managed LLCs owe the same fiduciary duties to each other.[61] Reflecting the general decentralized management structure and the mutual dependence on each other, all LLP partners and all LLC members owe to each other the fiduciary duties of loyalty and care.[62] Like general partners of limited partner-

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58. RUPA § 401(h), (j).

59. ALA. CODE § 10-12-24(b) (Supp. 1998).

60. *See id.* § 10-12-28 (1994).

61. *Compare* ALA. CODE § 10-12-21(e) (Supp. 1998), *with* RUPA § 404. The newly amended Alabama LLC Act places the same fiduciary duties on members of member-managed LLCs as RUPA places on LLP partners. *See* Boles & Hamill, *supra* note 13, at 160-71 (outlining suggested fiduciary duty statutory provisions as well as needed commentary and examples).

62. *Compare* ALA. CODE § 10-12-21(e) (Supp. 1998), *with* RUPA § 404. RUPA differs from the UPA in this area in that the UPA did not extensively define the partners' fiduciary duties in the statutory provisions. The UPA, instead, left detailed development of those duties to the common law of agency. RUPA § 404 cmt. 1. RUPA § 404(b) limits a partner's duty of loyalty to the following: (1) accounting to the partnership and holding as trustee any property, profit or benefit the partner derives through the conduct or winding up of the business, use of the partnership's property, or through appropriation of an opportunity of the partnership; (2) refraining from dealing with the partnership on behalf of a person with an adverse interest to the partnership whether it be in the conduct or the winding up of partnership business; and (3) refraining from competing with the partnership prior to its dissolu-

ships, in the manager-managed LLC structure generally only the managers owe fiduciary duties.[63] In a pure centralized management structure, fiduciary duties are only appropriately imposed on those who are depended upon to run the business. Under the LLC statute, if non-managing members acquire authority related to the business through the operating agreement, those non-managers owe fiduciary duties commensurate with their management powers.[64] The more management authority acquired by the non-managing members, the greater the level of fiduciary duties owed.[65] If the non-managing members of man-

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tion. RUPA § 404(b). The LLP partner's duty of care only requires the partner to avoid "engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of [the] law" while conducting or winding up the business of the partnership. RUPA § 404(c). Despite the fact that the LLP partner only has the fiduciary duties of loyalty and care, the partner is required to carry out those duties and all other duties imposed by RUPA consistent "with the obligation of good faith and fair dealing." RUPA § 404(d).

Although RUPA allows the partners to alter the default fiduciary rules, "neither the fiduciary duties of loyalty or care, nor the obligation of good faith and fair dealing, may be eliminated entirely." RUPA § 103 cmt. 4. The statute explicitly states that the partnership agreement may identify activities which do not violate the duty of loyalty. RUPA § 103(b)(3)(i). The partners may also ratify, "after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty." RUPA § 103(b)(3)(ii). The fiduciary duties listed in the newly amended Alabama LLC Act are identical to those listed in RUPA. *Compare* RUPA § 404, *with* ALA. CODE § 10-12-21 (Supp. 1998).

63. ALA. CODE § 10-12-21(e), (k)(2) (Supp. 1998); UNIF. LTD. LIAB. CO. ACT § 409(h)(2) (1995) [hereinafter ULLCA]. General partners of limited partnerships owe fiduciary duties similar to those owed by partners of general partnerships. *See* ALA. CODE § 10-9B-1205 (Supp. 1998) (providing that the Alabama Uniform Partnership Act of 1996 applies to any issue not specifically covered by the Alabama Limited Partnership Act of 1997); *id.* § 10-9B-403(a) (stating that "a general partner of a limited partnership has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners"); CALLISON, *supra* note 46, § 21.07 (citing RULPA § 403(a) (1985) (providing that "a general partner of a limited partnership has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners")); Sandra K. Miller, *What Standard of Conduct Should Apply to Members and Managers of Limited Liability Companies?*, 68 ST. JOHN'S L. REV. 21, 51-52 (1994) (stating that fiduciary duties owed by general partners in limited partnerships are the same as those owed by partners in a general partnership); *see also* Boles & Hamill, *supra* note 13, at 165 (discussing fiduciary duties of managers, general partners and corporate directors).

64. ALA. CODE § 10-12-21(k)(3) (Supp. 1998).

65. A member of a manager-managed LLC who takes on some managerial duties owes fiduciary duties on a "sliding scale." The member is held to the fiduciary standards imposed on managers "to the extent that the member exercises the managerial authority vested in a manager." *Id.*; *see* ULLCA § 409(h)(3), 6A U.L.A. 465

ager-managed LLCs participate in the business to a great extent causing them, in substance, to resemble partners of LLPs or members of member-managed LLCs, under the Alabama LLC Act these members will owe commensurate fiduciary duties.[66]

B. *Dissociation and Dissolution*

The LLP and LLC statutes offer radically different provisions addressing the rights of individual partners or members to dissociate and withdraw their capital from the LLP or LLC. RUPA statutorily guarantees all partners in a LLP the power to dissociate by voluntary withdrawal, even if the act of dissociating constitutes wrongful conduct,[67] while the LLC statute provides no dissociation rights. LLC members that want the rights to withdraw from the LLC and secure payment from the LLC or other members must bargain for those rights, often referred to as buy/sell agreements, in advance.[68] These contrasting approaches to business-exit rights, based squarely on partnership law in the case of the LLP and on corporation law in the case of the LLC, represent the most significant difference between the LLP and LLC.

Partners of LLPs enjoy dissociation rights beyond the power to voluntarily withdraw from the partnership.[69] RUPA contains an elaborate web of rules spelling out other occurrences, such as death or bankruptcy, that cause dissociation, resulting either in a buyout of the dissociated partner's interest or in the dissolution of the partnership.[70] Partnerships for a particular term or

(1995).

66. *See supra* note 61 and accompanying text; *see also* Boles & Hamill, *supra* note 13, at 167-68 (suggesting that manager-managed LLCs operating like a closely held business should more easily acquire fiduciary duty obligations under the sliding scale); Boles & Hamill, *supra* note 13, at 171 (arguing that fiduciary duties imposed on managers of widely held LLCs operating as traditional corporations should mirror corporate law).

67. RUPA § 602.

68. *See* ALA. CODE § 10-12-36 (Supp. 1998). Under the Alabama LLC Act, unless the operating agreement provides that a member may not withdraw from the LLC, a member may withdraw from the LLC, and thereby terminate all fiduciary duties and other obligations of membership. *Id.* However, the statutory default provision provides no rights of economic payment to a withdrawing member. *Id.*

69. RUPA §§ 601, 701, 801.

70. *Id.*

undertaking potentially dissolve upon all events of wrongful dissociation, such as voluntary withdrawal, bankruptcy, or judicial expulsion before the end of the term or undertaking.[71] If a majority-in-interest of the non-dissociating partners votes to continue the partnership, no dissolution occurs; instead, the partnership will redeem the interests of the dissociated partner and any other partner choosing not to continue.[72] By contrast, if the partnership has no specified term or undertaking, commonly referred to as a partnership at will, only a partner's voluntary withdrawal triggers a dissolution, and thereafter each partner has the right to demand a judicial sale.[73] RUPA provides no mechanism to avoid the dissolution by continuing the existing partnership. All other dissociation events simply trigger buyout rights for the departing partner.[74]

RUPA allows LLPs great flexibility to craft customized agreements addressing dissociation rights and dissolution of the partnership, but this flexibility is not unlimited. The partners can eliminate all dissolution triggers, explicitly set out their own rules defining wrongful and non-wrongful dissociations, and even eliminate the buyout rights associated with most of the dissociation events.[75] Despite this enhanced flexibility which did not exist under the Uniform Partnership Act,[76] RUPA preserves

71. *Id.* § 801.

72. *Id.* §§ 601, 701, 801.

73. *Id.* § 801(1) & cmt. 3.

74. RUPA §§ 603, 701.

75. *Id.* § 103. RUPA's default provision technically dissolving the partnership upon a partner's withdrawal is prompted by the concept of lingering liability. Farrar & Hamill, *supra* note 24, at 920. This concept is based on the idea that a departing partner may not feel comfortable allowing the entity to continue to exist for fear that situations may arise in which it will be difficult to determine whether the partnership incurred a particular liability before or after the partner's dissociation. *Id.* (citing 1 RIBSTEIN & KEATINGE, *supra* note 5, at §§ 11.14 & 11.16 (arguing that a partner should have the ability to dissolve the entity in order to cut off lingering personal liability)). Because the LLP possesses the corporate veil of limited liability, lingering liability should not be a consideration for departing partners. Therefore, partners of LLPs concerned about the instability often resulting from a judicial sale should consider adopting a partnership agreement that eliminates all dissolution triggers. Even if a liability were incurred prior to the partner's departure, his personal assets will not be at risk because of the presence of the limited liability shield. *See* RUPA § 401.

76. The UPA § 29 provides that a partnership is dissolved any time a partner leaves. RUPA § 801 cmt. 1. Consequently, the following events lead to dissolution of a partnership under the UPA: (1) end of a definite term; (2) accomplishment of a

the absolute power of each partner to dissociate by voluntary act.[77] Although the creation of a term or undertaking will make these dissociations wrongful, thus subjecting the withdrawing partner to financial penalties, the partnership agreement cannot eliminate the basic power to dissociate.[78]

As already noted and in contrast to partners in a LLP, LLC members possess no statutory rights to dissociate and withdraw their capital from the LLC. LLC members that wish to create dissociation and buyout rights must negotiate buy/sell agreements.[79] Because a majority of members arguably can authorize salary payments to themselves while leaving out the minority members, LLC members who fail to plan ahead by contracting for buyout rights run the same risk of being sub-

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particular undertaking; (3) expulsion of a partner pursuant to the partnership agreement; (4) a partner's withdrawal by express will; and (5) by operation of law (including death or bankruptcy of a partner or the partnership business becoming unlawful). UPA § 29, 6 U.L.A. 752 (1995). After dissolution, partnerships under the UPA are wound up and terminated. UPA § 30. Only those partners who have not wrongfully caused dissolution of the partnership are allowed to participate in winding up the partnership. *Id.* § 37.

77. RUPA § 103(b)(6) & cmt.

78. Under RUPA, a dissociation is wrongful if: (1) it is in breach of the partnership agreement, or (2) the partner withdraws by express will, is judicially expelled, becomes bankrupt, or willfully dissolved or terminated before the expiration of the term or completion of the undertaking in a partnership for a term or particular undertaking. RUPA § 602(b). RUPA provides many consequences for wrongful dissociation. For example, section 602(c) makes the wrongfully dissociating partner liable for damages. ROBERT W. HILLMAN ET AL., GENERAL AND LIMITED LIABILITY PARTNERSHIPS UNDER THE REVISED UNIFORM PARTNERSHIP ACT 210 (1996). In term partnerships, section 602(b)(2)(i) allows the other partners to withdraw within ninety days after a partner wrongfully dissociates. *Id.* Section 803(a) prohibits the wrongfully dissociating partner from participating in the winding up of the partnership business. *Id.* If the partnership is for a particular term, a wrongful dissociation will result in the dissolution and winding up of the partnership unless a majority-in-interest of the partners agrees to continue the partnership within ninety days of the wrongful dissociation. *Id.*

79. ALA. CODE § 10-12-36 (Supp. 1998). Until 1996, LLCs needed to remain technically dissolvable in order to lack continuity of life under the partnership classification regulations for federal taxpayers. The Internal Revenue Service's promulgation of the check-the-box regulations making all LLCs automatically taxable as partnerships eliminated the need for the organization to lack continuity of life, thus allowing state legislatures for the first time to consider eliminating all statutory dissolution and dissociation rights. Treas. Reg. §§ 301.7701-1 to -4 (as amended by T.D. 8697 (1996)); *see infra* text accompanying notes 115-17 (explaining that the elimination of all dissociation rights in the LLC statute was driven by federal gift and estate tax considerations).

jected to squeeze-out techniques commonly experienced by shareholders of closely held corporations.[80] Like minority shareholders of close corporations, these LLC members will have to prove a high level of wrongful conduct by the majority shareholders for a court to provide a remedy. LLCs whose members are least likely to bargain ahead of time concerning buyout rights will often be smaller, less sophisticated businesses using a member-managed or a manager-managed LLC structure that substantively resembles a LLP at the broadest level. Moreover, the LLC statute contains no oppression remedies similar to those found in corporation statutes, and the common law has not yet addressed whether minority LLC members can invoke the same remedies available to shareholders of close corporations.[81] Even if all close corporation remedies ultimately apply to minority LLC members by analogy, the corporate protection for the individual member falls far short of the partnership protections offered to the individual partner.[82]

Moreover, the opportunity for LLC participants to draft a buy/sell agreement will often serve as a poor substitute for the statutory dissociation rights that benefit all partners of LLPs. Because all rights under the buy/sell agreement must be defined in the contract, member-managed LLCs and manager-managed LLCs operating under a decentralized management structure that cannot afford substantial transaction costs may find it prohibitively expensive to create a well-drafted buy/sell agreement that adequately covers all the important issues. For example, a well-drafted buy/sell agreement should address events triggering the obligation to purchase as well as a valuation of the business interest in order to set the buyout price. A business's fair market value will change over time, thus creating the need to revalue the business periodically.[83] A poorly drafted buy/sell agreement that fails to adequately value the business on a periodic basis or contemplate unforeseen departures can cause more

80. *See* Farrar & Hamill, *supra* note 24, at 923-24.

81. *Id.* at 925-27.

82. *Id.* at 929-34.

83. The dissociation provisions under RUPA provide for a valuation method (the greater of going concern or liquidation) and value the departing partner's interest at the time of dissociation, thus eliminating any need to periodically revalue the partnership. *See* RUPA § 701(b) & cmt. 3.

harm than good.[84] Manager-managed LLCs, which operate in the same manner as limited partnerships,[85] will normally be able to afford the transaction costs to produce a well-drafted buy/sell agreement. However, members of many other LLCs attempting to draft buy/sell agreements without incurring the transaction costs necessary to cover all the issues may find themselves receiving woefully inadequate payment for their interests or being involuntarily ousted from the business.

C. Economic Sharing

The statutory provisions outlining how LLP partners and LLC members share profits and losses contain technical differences that may materially affect the business participants' choice between a LLP and a LLC, especially when focusing on the profits.[86] If the partnership agreement in the LLP fails to address profit allocations, the default provisions of RUPA provide for an equal sharing ratio, regardless of the partners' capital accounts.[87] RUPA's equal profit ratio derives its roots from early partnership law which assumed that partners join together

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84. In order to fully compensate the departing member, the buy/sell agreement should contain a provision for periodic revaluation of shares. If the business is small and unsophisticated, it is unlikely that the members will have either the time or the expertise to intermittently value LLC interests. A poorly drafted buy/sell agreement can produce disastrous results for the departing member because courts are reluctant to interfere with such agreements based on unfair price. *See, e.g.,* Concord Auto Auction v. Rustin, 627 F. Supp. 1526, 1529-30 (D. Mass. 1986) (refusing to order revaluation of shares upon a shareholder's untimely death where absolute responsibility of survivors to revalue was not clear); Gallagher v. Lambert, 549 N.E.2d 136, 137-38 (N.Y. 1989) (enforcing a buy/sell agreement triggered upon a shareholder's termination of employment under circumstances where the majority shareholders terminated the employment right before a higher share valuation would have applied; minority shareholder received $89,000 under a book value formula instead of $3,000,000 under a more accurate valuation formula which was scheduled to go into effect less than a month after the minority shareholder's employment was terminated); Evangelista v. Holland, 537 N.E.2d 589, 593 (Mass. App. Ct. 1989) (stating that the idea that "[t]he price established by a stockholders' agreement may be less than the appraised or market value is unremarkable").

85. An example of such an agreement can be found at 1 RIBSTEIN & KEATINGE, *supra* note 5, app. A.

86. *Compare* RUPA § 401(b), *with* ALA. CODE § 10-12-28 (1994).

87. RUPA § 401(b).

as co-proprietors principally contributing services.[88] Because RUPA recognizes oral partnership agreements and amendments as long as they are enforceable under contract principles,[89] and because most business participants at least discuss profits, few LLP partners will need to use the default provision to establish their profit sharing ratio.[90]

Unlike the LLP statute, the default provision of the Alabama LLC Act explicitly requires all operating agreements to be in writing.[91] Oral amendments are likewise unenforceable unless the written operating agreement provides for oral amendments to it.[92] Consequently, LLC members who rely on oral agreements to establish their profit sharing ratio may find their agreement unenforceable. If the members fail to enter into an enforceable agreement for sharing profits, the statutory default provision allocates profits in the LLC in the same ratio that the members share contributions made that have not been returned.[93] Thus, if a member only contributes services, that member runs a substantial risk of being denied a share of the LLC's profits under the default rule.[94] Under these circum-

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88. *See* UPA § 18(a), 6 U.L.A. 526 (1995).

89. Partnership law recognizes these oral agreements in order to validate and protect informal business arrangements that often organize as partnerships. RUPA § 101(6) & cmt. 2 (stating explicitly that oral partnership agreements are effective).

90. RUPA § 101(6). Due to the problems that may exist with proving the existence of an oral agreement and its contents, well-advised LLP partners will memorialize their profit sharing ratio in writing. *See* 2 BROMBERG & RIBSTEIN, *supra* note 32, § 6.02(b)(1) (stating that in the absence of an agreement, partners share profits equally regardless of whether capital or services were contributed unequally). Bromberg and Ribstein note that

> general partners in the sort of informal, closely held general partnership that does not have a customized agreement are usually "jacks of all trades," making a variety of contributions, including expertise and labor . . . and credit (that is, the ability to borrow money and the risk of personal liability). The partners' profit shares are intended to compensate for all of these contributions.

Id. (citing Stella v. Government Dev. Bank of Puerto Rico, 663 F.2d 326 (1st Cir. 1981)).

91. ALA. CODE § 10-12-24(b) (Supp. 1998). Approximately one-third of the states require the operating agreement to be in writing; the rest of the states recognize oral agreements. *See* 1 RIBSTEIN & KEATINGE, *supra* note 5, app. 4-1, at 30.

92. ALA. CODE § 10-12-24(b) (Supp. 1998).

93. *Id.* § 10-12-28 (1994).

94. *Id.* Because the technical language establishing the default profit sharing ratio refers to each member's "value of contributions," *id.* § 10-12-28, while services

stances, if the members contributing capital fail to acknowledge the oral agreement, the member contributing services may be forced to ask a court to recognize the oral agreement under a theory of unjust enrichment or some other equitable doctrine available under state law.[95]

The requirement that all operating agreements be in writing combined with the default profit sharing ratio will most likely cause unforeseen problems for small, informal businesses organized as member-managed LLCs or manager-managed LLCs operating under a decentralized structure—the same kind of business that often appears indistinguishable from the LLP. These business participants will often rely on oral agreements to share profits or assume they all have an equal sharing ratio. However, a larger, more complex business, operating as a traditional manager-managed LLC will generally incur the necessary transaction costs to negotiate a detailed written operating agreement.[96]

Compared to the statutory default provisions governing the profit ratio, the provisions concerning loss allocation ratios of LLCs and LLPs contain only minor differences. If the LLC members or the LLP partners fail to agree on how they bear losses, both statutes ensure that no member or partner will become personally liable to make contributions solely due to a default loss allocation. The rules governing loss allocations of LLCs are much easier to administer as a practical matter. Regardless of how the members of a LLC share profits, if they fail to agree on

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are explicitly identified as a contribution for which the member must pay the cash value if the member fails to perform, *id.* §§ 10-12-26, -27, one can argue that a service-contributor's profit ratio is based on the value of the service contributed. Although valuing the services may be difficult and may still produce a smaller profit share than the oral agreement, this argument may produce a stronger case for the service- contributor than the traditional equity remedies under contract law. Because the valuation of the services would only be to establish the service-contributor's percentage share of future profits and would in no event grant a current right to capital, the service-contributing member will generally recognize no taxable income until profits are earned and allocated. *See* Rev. Proc. 93-27, 1993-2 C.B. 343. Professor Hamill acknowledges the student in the Fall 1998 LLC class (exam no. 547) who came up with this argument in a well-written exam answer.

95. *Id.* § 10-12-24 (Supp. 1998). For an alternative argument, see the discussion in *supra* note 94.

96. See 1 RIBSTEIN & KEATINGE, *supra* note 5, app. A-23 & A-36 for an example of a standard profit sharing agreement.

a loss sharing ratio, the statute allocates losses according to their ratio of unreturned capital in the LLC.[97] With LLCs, these pro rata loss allocations will simultaneously reduce all members' positive capital accounts.[98]

If partners in a general partnership or a LLP fail to agree on how to bear losses, RUPA allocates losses in the same ratio as the partners share profits.[99] If a general partnership has not registered to be a LLP, the default loss ratio can create personal liability to satisfy another partner's positive capital account, if, for example, the partners contribute capital in unequal ratios but share profits equally. Under these facts, the allocation of losses equally under the statute will reduce the account of the partner contributing less capital to a negative number while the other partner's account will remain positive.[100] If the partnership has a LLP registration in effect, the default loss allocations still generally follow the ratio for sharing profits; however, once the losses bring a particular partner's capital account to zero, that partner cannot receive any more loss allocations.[101] Any additional losses must be allocated to any remaining partners with positive capital account balances.[102]

The difference between the default loss allocations in the LLC and LLP statutes will most often have significance when

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97. ALA. CODE § 10-12-28 (1994).

98. If no LLC member has a positive capital account but the LLC still shows losses that year, the only possible source of money creating those losses is borrowed funds. Because of the limited liability shield provided by the LLC filing, no member or manager can be held personally liable to pay the creditor absent an affirmative agreement, such as the execution of a guarantee. *Id.* § 10-12-20 (1994). Losses attributable to liabilities for which no member bears the economic risk of loss are only significant for tax purposes and are beyond the scope of this Article.

99. RUPA § 401(b).

100. *See* RUPA § 401(a)(2). Under fact patterns where the partners failed to agree to a loss sharing ratio, case law decided under the UPA sometimes created equitable exceptions relieving a partner from the responsibility of making a capital contribution to satisfy another partner's positive capital account. *See, e.g.*, Kovacik v. Reed, 315 P.2d 314 (1957). RUPA's default loss allocation ratio clearly follows profits even if the lost allocation creates an obligation to restore another partner's positive capital account. Consequently, the equitable exceptions under UPA law carry substantially less weight in states that have adopted RUPA. RUPA § 401 cmt. 3.

101. *See* RUPA § 306(c).

102. RUPA §§ 306(b), 807(b); *see supra* note 98 and accompanying text (discussing negative capital accounts created from losses attributable to borrowed funds; the treatment of LLP partners receiving loss allocations when no partner shows a positive capital account is the same as LLC members).

the business venture involves some participants contributing primarily capital while the other participants contribute primarily services, and the participants fail to discuss losses. For example, if the partners of a LLP have interests in capital reflecting a seventy percent, twenty percent, and ten percent ratio but agree to share profits equally, the initial loss allocations under the default provision will follow the profit ratio—one-third of all losses for each partner.[103] However, once the partner with an initial ten percent capital interest shows a capital account of zero, the losses must be allocated to the remaining two partners who still have positive capital accounts. At that point, only the partners still showing positive capital accounts can receive additional losses by default.[104] Once the partner with an initial twenty percent capital interest shows a capital account of zero, the losses must be allocated to the only remaining partner with a positive capital account, the partner who initially contributed seventy percent of the capital.[105] If the hypothetical business in the above example were operated as a LLC, the loss allocations under the default rules would simply follow the members' ratio of unreturned capital—seventy percent, twenty percent, and ten percent—causing the members' capital accounts to reach zero at the same time and rendering the complex re-allocations under the LLP model unnecessary.[106]

The differences between the default loss allocation rules of LLCs and LLPs boil down to timing. In both entities, the default loss allocation rules will eventually reduce all positive capital accounts to zero but can never singlehandedly create an obligation to make contributions to the LLC or LLP. However, depend-

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103. RUPA § 401(b).

104. *See* RUPA § 306(c).

105. In this hypothetical, once the ten-percent capital contributor can no longer receive loss allocations, the remaining losses must be allocated between the two partners who still have positive capital accounts. Under the facts, each of these two partners is entitled to one-third of the profits, but each has a different ratio of unreturned capital. Because RUPA technically requires all losses to follow profits and only forces a re-allocation to prevent a zero capital account from becoming a deficit, the remaining losses should be allocated equally (reflecting that each of the two remaining partners have a one-third profit interest; with respect to each other, each has an equal claim to the partnership's profits) until one of the partner's capital account reaches zero.

106. ALA. CODE § 10-12-28 (1994).

ing on the individual business participant's capital contribution and share of profits, the default loss allocations will either more slowly or more quickly reduce that person's capital account under the LLC or LLP rules. Under RUPA, partners with a larger share of profits and smaller share of capital will receive a greater percentage of losses, causing their capital account to reach zero faster; partners with a smaller share of profits and a larger share of capital will receive a lesser percentage of losses, causing their capital account to reach zero more slowly.[107] The loss allocation rules for LLCs create an opposite effect. Members with larger capital accounts receive a greater percentage of losses than members with smaller capital accounts. Because the loss allocation percentage mirrors the capital accounts, the LLC members' accounts will reach zero at the same time.[108]

III. CHOOSING BETWEEN THE LLC AND LLP ON A PRACTICAL LEVEL

While the LLP and LLC are similar in many respects and often difficult to distinguish, there are many situations in which the LLC clearly represents the better choice for a business. As noted above, because the LLP offers no statutory mechanism for formally centralizing management, the manager-managed LLC will be the best choice when the participants truly desire a centralized management structure. Such businesses include high-risk, leveraged real estate or natural resource ventures and other businesses in which the majority of the capital is contributed by passive investors.[109] Before the LLC became available, virtually all of these businesses were conducted in the limited partnership form. Any such business that traditionally would have operated as a limited partnership[110] should choose the

107. RUPA § 401(b).

108. ALA. CODE § 10-12-28 (1994).

109. *See* Terrence Floyd Cuff, *California Limited Liability Company Act*, 374 PRAC. L. INST. TAX 9, 46 (1995); Brian L. Schorr, *Limited Liability Companies: Features and Uses*, 869 PRAC. L. INST. CORP. 275, 281 (1994).

110. Alabama allows registration as a limited partnership for almost any purpose. *See* ALA. CODE §§ 10-9B-101 to -1206 (Supp. 1998) (providing for registration as a limited partnership in Alabama); *see also* Hamill, *supra* note 9, at 426 (stating that "[m]ost nonpublicly traded limited partnerships have been used for real estate and

manager-managed LLC instead of the LLP. Because these investment-oriented business ventures typically engage in adequate business planning, including having a detailed operating agreement, the potential traps hidden in the LLC default provisions should not cause any negative effects for these businesses. These potential traps include the ambiguous standard for authorizing salaries,[111] the writing requirement for operating agreements,[112] the default profit sharing ratio,[113] and the absence of dissociation rights.[114]

The LLC is also the better choice for family businesses where the participants have estate and gift tax planning as a major goal. Apparently, the goal of making LLCs suitable for gift and estate tax planning for family businesses constituted a major reason for eliminating dissociation rights in the LLC statute.[115] In order to qualify for discounted valuation for gifts and bequests among family members, the business interest, pursuant to federal law, must be nontransferable and non-liquid as a matter of state law.[116] Therefore, because LLPs preserve the absolute right of the partners to dissociate and have their interests redeemed by the partnership, LLP interests will never qualify for discounted valuation if transferred among family members in the gift and estate tax context.[117] Because estate planning normally involves a fair amount of legal advice, family businesses that choose LLCs, in order to qualify for discounted valuation of gifted or bequeathed interests, will not likely be caught by the traps hidden in the LLC's default provisions.

The third type of business for which the LLC is clearly the better choice is one in which the participants desire a business form as close to the corporate structure as possible. Often these

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other investment ventures"); Hamill, *supra* note 9, at 427 (stating that "limited partnerships have on balance been investment-oriented arrangements designed to produce, when the economics of the investment interface with the tax rules, tax losses").

111. *See supra* notes 52-60 and accompanying text.

112. ALA. CODE § 10-12-24(b) (Supp. 1998).

113. *Id.* § 10-12-28 (1994); *see also supra* notes 50-54, 91-96 and accompanying text.

114. *See supra* notes 79-85 and accompanying text.

115. *See supra* note 79.

116. *See* Farrar & Hamill, *supra* note 24, at 934-38.

117. *Id.* at 934-40.

will include small, active businesses or joint ventures that want a formal centralized management structure, even if they use the operating agreement to undercut it.[118] Often these businesses desire the corporate form to avoid the liquidity problems that sometimes result from dissociation rights or simply for the intangible reason of familiarity. Corporations have been around since America's beginnings, and for most of the twentieth century they have held their place as the dominant business form.[119] The LLC represents the most logical choice for such businesses because the Alabama LLC, with the elimination of dissociation rights and the presence of capital-based economic sharing default rules, more closely resembles a corporation than any other business form.

Conversely, the LLP probably represents the preferred choice for business participants who have traditionally used general partnerships. Law and accounting firms are the prime examples of entities that have historically organized as general partnerships, thus making them good candidates for LLP registration. Typically, these firms make an effort to centralize management through the use of internal management committees. The fact that such internal governance rules do not affect third parties has not been a concern of law firms and other professional organizations. Usually law firms do not experience the problems that arise when a partner conducts transactions beyond the scope of his authority. Sophisticated expulsion agreements will normally discourage partners from violating the internal management committee structure agreed upon. As a result, there is no need for these firms and other professional organizations, which customarily organize as general partnerships, to move to an entirely new business form. The expectations of the owners make the LLP, which is, in effect, a general partnership, the better choice.[120]

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118. *See* Robert R. Keatinge, *Corporations, Unincorporated Organizations, and Unincorporations: Check the Box and the Balkanization of Business Organizations*, 1 J. SMALL & EMERGING BUS. L. 201, 237-41 (1997).

119. *See generally* Hamill, *supra* note 6 (discussing the development of corporations in American history).

120. *See* Martin C. McWilliams, Jr., *Limited Liability Law Practice*, 49 S.C. L. REV. 359 (1998) (discussing the use of LLPs for law firms); ALA. CODE § 10-8A-1010 (Supp. 1998) (providing professionals the opportunity to register as a LLP); *see also* 1 RIBSTEIN & KEATINGE, *supra* note 5, § 2.23 (stating that "some professionals have

Unsophisticated businesses that either cannot afford the transaction costs of completing an elaborate operating agreement or have not even considered entering into a written agreement will typically be better off choosing the LLP. Such businesses include those that consist of a small amount of capital and few participants, all or most of whom are heavily involved in the business. Some owners may contribute services to the business because they are unable to contribute capital. The prototype of this business encompasses the classic closely held corporation.

The closely held corporation evolved during the last half of the twentieth century as an alternative to the general partnership.[121] Before the development of the LLC and the LLP, the only option for a small business wanting to secure limited liability was to incorporate and operate as a closely held corporation.[122] Because the default rules of the corporate statutes largely failed to conform to the expectations of small businesses, many close corporation shareholders experienced significant problems, especially with freeze-outs.[123] The ability of a general partnership to register as a LLP provides small businesses, which would have otherwise used a close corporation, the opportunity to combine partnership business characteristics with limited liability.[124] Because the LLC's business characteristics have gravitated more toward the corporate side, the LLP offers a better choice over the LLC for these small businesses.

The following hypothetical business illustrates how the technical differences between LLCs and LLPs in Alabama may significantly impact the participants:

A, B, C, D, and E are all old college friends who decide to

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preferred the LLP because, as a form of general partnership, it is more similar to the partnership form with which they are familiar"). Ribstein and Keatinge have noted that in some organizations, registration as a LLP is important for the owners because they want to able to refer to each other as "partners." 1 RIBSTEIN & KEATINGE, *supra* note 5, § 2.23.

121. *See infra* note 122 and accompanying text.

122. Until the 1990s, the close corporation was the main business organization choice for small businesses that wanted to obtain limited liability protection. *See* CHARLES R. O'KELLEY JR. & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 359-62 (1992).

123. *See* Farrar & Hamill, *supra* note 24, at 924-28.

124. *See* Keatinge, *supra* note 118, at 208.

open a video rental and sales store together. A and B agree to contribute seventy-five percent and twenty-five percent, respectively, of the capital needed for the business, but will not work in the store. C, D, and E decide to devote their full time to running the business.

The group agrees to share profits equally, but fails to put the agreement in writing. Because they are sure that the business will be successful, they do not discuss losses. The group also decides to designate A as the tax matters partner, but all five owners participate in and vote on other matters affecting the operation of the business.

In the first three years of operation, due largely to start-up expenditures, the entity experiences an overall loss. In year four, the entity breaks even. In years five through seven, the entity realizes a profit, which increases yearly. Because they feel that the profitability of the entity is due entirely to their efforts, C, D, and E become dissatisfied with their profit share in year 8 and demand that A and B, who have not been contributing services to the business, take a smaller share of the profits.[125]

There are many problems that may arise if the entity discussed in the hypothetical were formed as a LLC. The parties' oral agreement to share profits equally may not be enforceable because the Alabama LLC Act requires that operating agreements be in writing.[126] If the statutory default profit sharing ratio applies, C, D, and E, the members who only contributed services, could be denied any portion of the profits because the default ratio reflects the percentage of capital contributed. The capital contributors (A and B) would be entitled to seventy-five and twenty-five percent of the profits, respectively, an unconscionably harsh result for the service-contributors (C, D, and E).[127]

In addition to the potential injustice caused by the statute's writing requirement, the participants will encounter even bigger

125. Although businesses typically have debt, this hypothetical entity has no debt in order to simplify the illustration.

126. ALA. CODE § 10-12-24(b) (Supp. 1998); *see supra* notes 91-95 and accompanying text.

127. *See id.* § 10-12-28 (1994). For additional arguments available to C, D, and E, see discussion at *supra* note 94. Under the Alabama LLC statutory default rules, A and B will initially bear all losses seventy-five and twenty-five percent, respectively, reflecting their capital contribution ratio. C, D, and E can only bear losses if they have been previously allocated profits while not receiving those profits as distributions. *See supra* note 94.

obstacles if they decide to separate from the business following a disagreement. Disagreements such as the one in the hypothesized situation are not uncommon. The discord results from the fact that the owners who are actively involved in running the business often believe that the profits of the business are generated, for the most part, from their efforts and not from the financial investments made by the owners who are not actively involved in the business.[128] The owners providing the lion's share of the financial capital rather than services, of course, will rarely agree with this view.[129]

This universal tension between the owners providing most of the capital and the owners providing most of the services, in conjunction with Alabama's elimination of dissociation rights may spell trouble for A and B if they want to remove their capital from the video store and invest it in another venture. Because C, D, and E constitute a "corporate majority" on a per capita basis, those three may be able to suspend all distributions and authorize salary for themselves while excluding A and B from receiving any current return on their investment.[130] Because members of Alabama LLCs do not possess dissociation rights and A and B have not entered into a buy/sell agreement, A and B (the minority members) from a vote perspective, are vulnerable to the squeeze-out techniques very commonly seen in close corporations.[131]

While the Alabama LLC form proved to be problematic for the hypothesized business, the LLP form, although not perfect, will more likely result in consequences that are fair to all five owners. Under RUPA the oral agreement to share profits equally will be enforceable, thus protecting the service-contributors far better than the LLC. Moreover, the default provisions of RUPA addressing governance and voting provide much better protection for the capital-contributors who, as a group, possess

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128. Gevurtz, *supra* note 46, at 510 (citing F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 2:03 (2d ed. 1995)).

129. *Id.*

130. *See supra* notes 51-54 and accompanying text. Although C, D, and E will not be able to authorize distributions for themselves while excluding A and B, arguably the decision to authorize salary payments is an ordinary decision, needing only majority approval on a per capita basis.

131. *See* ALA. CODE § 10-12-36 (Supp. 1998); *see also* Gevurtz, *supra* note 46, at 498-501 (discussing freeze-outs in close corporations).

less voting strength than the service-contributors. Although the majority group (C, D, and E) controls all ordinary business decisions of the partnership, C, D, and E must obtain A and B's consent for all extraordinary business decisions, including the authorization of salary payments.[132] By requiring all five partners to agree to authorize a salary payment or a distribution that varies from the profit sharing ratio, the LLP statute contains powerful safeguards preventing the squeeze-out techniques so common among close corporations and now a serious risk for LLC members.[133] Because all partners of LLPs have the right to dissociate, A and B, or any of the other partners who are not satisfied with their share of the profits, will be able to withdraw from the partnership.[134] Because this partnership is at will, a partner's withdrawal triggers a dissolution, providing the partners with the right to demand a judicial sale of the partnership assets.[135] Although the presence of dissociation rights should encourage the partners to work out their differences rather than resort to litigation, the judicial sale potential may cause problems for C, D, and E, the partners least able to economically compete for the business.[136]

132. ALA. CODE § 10-8A-401(j) (Supp. 1998); RUPA § 401(j); *see supra* notes 44-46 and accompanying text.

133. *See supra* notes 46, 51-54 and accompanying text.

134. ALA. CODE §§ 10-8A-601, -602 (Supp. 1998); RUPA § 602.

135. ALA. CODE § 10-8A-801(1) (Supp. 1998); RUPA § 801(1).

136. *See* RUPA §§ 601, 701, 801; *see also supra* notes 73-74 and accompanying text (discussing dissolution and judicial sale of partnership). If one partner is wealthier than the other partners, the opportunity to buy the partnership's assets at a judicial sale may be of little value to the disadvantaged partner because he cannot adequately compete for control. *See* Farrar & Hamill, *supra* note 24, at 915-18 (explaining how uneven wealth among the partners sometimes resulted in unfair bidding for the business under the UPA rules); *id.* at 933-34 (arguing that the potential for abuse due to uneven wealth can be mitigated if dissociation does not result in dissolution due to statutory valuation standards setting the price rather than the judicial sale; also arguing that unfairness in the judicial sale process can be mitigated by expanding the definition of wrongful dissociation). In the hypothetical business, A, who contributed seventy-five percent of the capital, probably has more economic resources than any of the other partners, especially those who could only afford to contribute services. As a result, she could possibly use her economic advantage to outbid the other partners at a public sale.

IV. CONCLUSION

Significant developments in the area of unincorporated business organizations which offer limited liability have resulted in great interest in such entities. As a result, the LLC and LLP have gained prominence among unincorporated business forms. The LLC and LLP became a choice for doing business in Alabama by acts of the legislature in 1993 and 1996, respectively. Those two entities were the first instances in which a business organized in Alabama had the opportunity to effectively operate as a general partnership with limited liability. Due to the legislature's recognition of the two entities, Alabama lawyers electing to organize a business in an unincorporated business organization offering limited liability now face the task of choosing between the LLC and the LLP which are often difficult to distinguish. The difficulty in distinguishing between these two entities stems, in part, from the fact that member-managed LLCs, many manager-managed LLCs, and LLPs all derive their most basic roots from the general partnership. Despite the broad-based similarities of Alabama LLCs and LLPs, the statutory default provisions of the two business forms contain material differences that can significantly impact small, unsophisticated businesses that do not engage in careful business planning.

In the area of management and fiduciary duties, member-managed LLCs and LLPs enjoy almost complete parity—both statutes vest substantial management powers in all of the members. Additionally, manager-managed LLCs can easily use the operating agreement to vest management powers with the non-managing members who will automatically owe commensurate fiduciary duties. However, the LLC and LLP statutory schemes for voting on business decisions contain material differences. These differences are especially apparent in the area of salary authorization where LLPs require unanimity, while LLCs arguably can authorize salary by mere majority. The area of dissociation and dissolution is also one in which Alabama LLCs and LLPs have fundamental differences. Because Alabama has adopted a version of RUPA, LLP partners are allowed to dissociate from the partnership at any time. Although the partners possess the power to eliminate partnership dissolution and a judicial sale, the agreement cannot eliminate the power to dissociate and receive payment based on statutory or contractually defined valuation standards. However, as of January 1, 1998, Alabama LLC members possess no statutory dissociation rights, thereby making Alabama LLC members similar to shareholders of closely held corporations.

LLPs follow the general partnership model for economic sharing. In absence of a written or oral agreement to the contrary, LLP partners share profits equally and losses according to the profit sharing ratio. In accordance with the limited liability concept, partners are not required to bear any losses once their capital account reaches zero. Economic sharing in the LLC is based upon the limited partnership model rather than the general partnership model. Unless there is a written agreement stating otherwise, LLC members are required to share profits and losses in the same ratio as unreturned capital. The failure of the Alabama LLC statute to recognize oral agreements can result in unfair consequences in the area of economic sharing. A member who contributes a small amount of capital, but relies on an oral agreement establishing a higher profit sharing ratio than her capital account may find that the Alabama LLC statute only entitles her to a share of the profits equal to her capital ratio. The oral agreement establishing the profit sharing ratio among the members carries no legal effect unless the LLC member successfully invokes equitable remedies.

The choice between the LLC and LLP in Alabama essentially comes down to a consideration of the type of business and the level of business planning available to the participants. Businesses needing a centralized management structure that would otherwise choose a limited partnership will find the LLP unacceptable and therefore should select the manager-managed LLC. Other businesses contemplating a more flexible management structure than strict centralized management will find both the LLC and the LLP to be acceptable choices if the organization of the business will involve a high level of planning and a very detailed agreement which covers all aspects of the business. However, the LLP will be a much better choice if the owners lack the economic resources to engage in careful business planning and therefore are unable to obtain the degree of advice required for a detailed operating agreement. Technical aspects of the LLC's default provisions, such as the inability to dissociate, the arguable ability to authorize salaries by a majority vote, the requirement of a written operating agreement, and a profit sharing ratio that essentially looks to unreturned capital, are more likely to negatively affect owners of small, informally run businesses with fewer economic resources. The LLP provisions, although not perfect, on balance will represent the better choice for business participants that are unable or unwilling to shoulder the transaction costs of a very detailed operating agreement.