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Pennsylvania Partnership and LLC Law Revised

Suzanne A. Prybella & James C. Vandermark

Pennsylvania recently enacted new legislation that will enable attorneys, estate planners, and other professionals to advise clients seeking to place assets in a limited liability company with greater confidence when addressing issues regarding the protections afforded by the limited liability company form. Prior to February 21, 2017, Pennsylvania followed the Pennsylvania Limited Liability Company Law (15 Pa. C.S. § 8901 et seq.) (the "PLLC Law"). The PLLC Law was similar to Delaware's Limited Liability Company Act in that it included provisions regarding transfers of membership interests (which included both economic rights and rights to participate in the management of the business).

The PLLC Law, however, did not provide clear guidance with respect to the property rights of members or to what extent creditors could recover against a member's interest in the limited liability company. Instead, members were left to faceoff in court to define the member's property interests and the extent to which creditors could recover against such interests for the unpaid debts of the member. The uncertainty as to the protections available under the PLLC Law caused some clients to consider other entity forms and alternative jurisdictions.

On April 1, 2017, the Pennsylvania Uniform Limited Liability Company Act of 2016 (15 Pa. C.S. § 8811 et seq.) (the "PULLC Act") became fully effective and replaced the PLLC Law.[1] Unlike its predecessor, the PULLC Act specifically defined the interests held by a member. For example, it defined "transferable interest" as the "right, as initially owned by a person in the person's capacity as a member, to receive distributions from a limited liability company, whether or not the person remains a member or continues to own any part of the right."[2] The PULLC Act also makes clear that a member's transferable interest is personal property and such transferable interest is the only right that may be transferred to non-members. Thus, if a member sells or otherwise transfers their transferable interest, the recipient of the transferable interest has only the right to receive that member's distributions. The member is not dissociated as a member from the LLC and the recipient is not entitled to:

(i) participate in the management or conduct of the company's activities and affairs; or

(ii) …have access to records or other information concerning the company's activities and affairs.[3]

The PULLC Act also provides significant clarification as to the rights of creditors, which are limited to those rights provided for under the PULLC Act. This includes charging orders as the sole remedy available to judgment creditors for obtaining distributions made by the limited liability company. If a creditor is able to obtain a charging order, it will be a lien against the member's transferable interest and requires the limited liability company to pay over to the creditor any distributions that would otherwise be paid to the member. The creditor can also have a receiver appointed to ensure distributions are paid to the creditor. However, because the creditor is only able to recover against a transferable interest, the PULLC Act makes clear that it does not cause the dissociation of the member or a dissolution and winding up of the limited liability company.

Diverging from both the PLLC Law and Delaware law, the PULLC Act allows a judgment creditor to foreclose the transferable interest of the member. In most cases, the purchaser at the foreclosure sale will only obtain the transferable interest and does not thereby become a member. This is because the purchaser is also subject to PULLC Act's provisions relating to transfers of transferable interests, as discussed above. However, there is a significant caveat to this rule as it pertains to sole member limited liability companies. The PULLC Act allows creditors foreclosing against the sole member of a limited company, to force the sale of the member's entire interest, not just their transferable interest.

Enactment of the PULLC Act was part of a much larger amendment[4] to Title 15 (Corporations and Unincorporated Associations) to replace the law governing limited liability companies, limited liability partnerships, limited partnerships and general partnerships. In particular, the following changes are notable from a fiduciary obligation and asset protection standpoint:

Limited Liability Companies

- Clarifies that although a limited liability operating agreement may not completely eliminate the duty of loyalty or the duty of care of its members, it may specify (reasonable) conduct that does not violate such duties.
- Permits the transfer of any distribution right by a member of an LLC pursuant

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to any terms or restrictions on transfers imposed by the LLC's operating agreement.

- Specifies that a member is not an agent of the LLC, solely because it is a member of such LLC, thus eliminating the "statutory apparent authority" which was previously the law.
- Expands the permissible purposes of an LLC to include not-for-profit purposes. Previously, Pennsylvania law only permitted not-for-profit purposes with respect to corporations. A nonprofit LLC is permitted to receive and hold real property in trust for the purposes set forth in its Certificate of Organization. A nonprofit may want to create an LLC for a number of reasons, including for protection from the risks and liabilities associated with the ownership of real property or to operate a business that is not substantially related to advancing the nonprofit's exempt purpose (without jeopardizing its 501(c)(3) status under federal law).
- Creates "Benefit Companies" or "Benefit LLCs" which are entities whose purpose must be for general public benefit (and may be for a specific public benefit) meaning that it must have a "material positive impact on society and the environment, taken as a whole and assessed against a third-party standard, from the business and operations of a benefit company". The third-party standard must be maintained by the entity and any reports and assessments confirming the third-party standard must be made publicly available (which means Benefit Companies will be very transparent entities).

Limited Liability Partnerships

- Clarifies that the agreement among partners governs the partnership and that the rules of the Uniform Partnership Act are generally the default rules. Further clarifies that property is owned by the partnership and not by individual partners.
- Provides that a partner has duties of loyalty and care to address suits by partners for breach of fiduciary responsibilities.
- Provides the general partners of an LLP with liability protection similar to that enjoyed by shareholders of a corporation and members of a limited liability company.
- Creates distribution tests which address the ability of creditors to recoup improper distributions in light of the partners' shield from liability.
- Provides for the satisfaction of creditors upon liquidation (similar to corporations).

Also worth noting is that the inaction of the Uniform Limited Partnership Act severs the link between limited partnership law and general partnership law and creates an independent source of law with respect to limited partnerships.

Footnotes:

1 The PULLC Act became partially effective on February 21, 2017. During the interim period between February 21, 2017, and April 1, 2017, the PPLC Law governed only (1) limited liability companies formed on or after February 21, 2017 and (2) limited liability companies previously formed and that elected to be governed by the PULLC Act.

2 15 Pa.C.S. § 8812(a).

3 15 Pa.C.S. § 8852(a)(3).

4 See Pennsylvania House Bill #1398 (Act 2016-170)

Suzanne Prybella, an associate at White and Williams LLP, focuses her practice on commercial lending transactions as well as on estate planning and tax matters. In her practice, Suzanne advises clients on estate and wealth transfer planning, asset protection planning and estate administration, as well as issues involving federal, state and local taxation. In addition, she advises clients on issues regarding the qualification and maintenance of tax-exempt status.

James Vandermark, an associate at White and Williams LLP, concentrates his practice in the areas of bankruptcy, tax, and commercial law. He represents a variety of businesses, including financial institutions, corporations, insurance companies and government entities. His experience includes advising creditors and debtors in commercial and consumer bankruptcy cases as well as complex state and local tax matters. James also represents clients involved in bankruptcy restructuring efforts and adversarial proceedings, disputes involving business tax and real estate tax assessments, and other sophisticated commercial litigation matters.