# LEGAL OPINIONS ON LLCs

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State Bar of Texas
**CHOICE AND ACQUISITION**
**OF ENTITIES IN TEXAS**
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**CHAPTER 10**

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 **Adrienne Randle Bond** specializes in energy and energy finance law, including E&P acquisitions, and related equity and debt financing, and representation of oilfield service companies. Skills include the formation of limited liability companies, corporations and partnerships, SEC compliance issues, private placements, corporate compliance, and acquisitions or sales of assets, routine contract issues for E&P and oilfield service companies, including farmout or participation agreements, joint operating agreements, master service agreements, and gas purchase agreements. She is licensed in Texas and Colorado.

**EDUCATION**

Ms. Bond is a *magna cum laude* graduate of Rice University (B.A. 1980) and graduated Columbia University Law School (JD, 1980) as a Harlan Fiske Stone Scholar.

**ADMITTED**

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**PROFESSIONAL MEMBERSHPS**

- Texas Bar Association
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- Houston Bar Association
  - *Mergers and Acquisitions Section*
- Colorado Bar Association
- American Bar Association
  - *Business Law Section and Environment, Energy and Resources Section*
  - *Distressed M&A Committee*
  - *International Use of U.S. Business Entities Committee*
  - *LLC, Partnership and Unincorporated Entities Committee*
  - *Mergers and Acquisitions Committee*
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**PROFESSIONAL ACTIVITIES**

She is a frequent author and lecturer on corporate and securities law issues, and has served as Adjunct Professor of Corporate Law and Securities Law at the University of Houston Law Center. Ms. Bond is a past President of the Women's Finance Exchange and has been a member of the State Bar of Texas' Corporation Law, Continuing Education and Venture Capital Committees. She services on the Board of Directors of the Neuhaus Education Center.

**REPRESENTATIVE TRANSACTIONS**

- Representation of E&P companies in the purchase and sale of oil and gas properties, from purchases in the $1-$15 million range, to significant acquisitions and divestures in the $300 million to $500 million range.

- Representation of owners of oil field service companies in the preparation and sale of their businesses.
- Preparation and execution of company and tax structures to efficiently operate the business or prepare it for marketing and sale
- Negotiation on behalf of family owned businesses of private equity and debt funding for the purchase of significant domestic assets from a major oil and gas companies.
- Preparation and sale of a privately held oil and gas business to a publicly traded company.
- Negotiation of private equity and related debt financing for oil and gas assets in financial distress.
- Representation of clients in leasing, exploration, participation, farmout and seismic acquisition agreements.
- Preparation of confidentiality agreements, employee confidentiality agreements, employment agreements and related compensation through equity ownership in exchange for services (sweat equity).
- Preparation of master service agreement and related agreements for providing or purchasing oilfield services.
- Planning and executing business and tax structures for newly formed or growing businesses.
- Preparation of employment agreements, and related compensation arrangements through equity such as carried interests, stock options and restricted stock or equity plans.

**PERSONAL:**

She speaks Spanish, French, and Portuguese. In her leisure time, she enjoys wildlife photography and her dog.

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## I. INTRODUCTION

As the use of the limited liability company ("LLC") has significantly expanded, the bar has been required to examine and refine its customs and practices in the giving of closing opinions for LLCs. Historically, the preponderance of entities participating in financing or acquisition transactions was corporations. The swell of LLC formation, however, has outstripped the historical corporate practice, and LLCs are now the common entity used. Because of the several fundamental differences between LLCs and corporations, it stands to reason that traditional "corporate" legal closing opinions must be reconfigured to meet the specific characteristics of an LLC. One cannot simple perform a "global search" and replace "corporation" with "company." The form of legal opinion for LLCs must be substantially rewritten, and the underlying due diligence tasks to give the opinion must be redefined. Even the topics that are required to be discussed in a legal opinion must be reformulated from the traditional corporate formulations.

I plan to cover two areas: general legal principles that are invoked in the preparation and delivery of a closing opinion, and specific opinion provisions for the core opinions that are generally given about an entity in a financing or acquisition transaction. General principles have been affected by the expanded use of LLCs because the general principles depend on customary practices from corporate practice, and customary practices have been adapted to the unique features of an LLC. Further, the Bar has developed new and more precise diction with respect to the actual language used in the traditional core opinions given.

As this paper will demonstrate, the core issue in properly rendering an LLC opinion, is that the LLC, as a result of the enabling statutes, the developing case law, and in LLC Agreement itself, is subject to the law of contract. In contrast, corporations are more defined by the corporate statute and related state law filings. LLCs, however, are defined by the content of their contract (the LLC Agreement), while corporations are largely defined by the enabling statutes and case law developed under the statutes. Great portions of the basic entity opinions about corporations can be ascertained from the state statutes and filings with the applicable secretary of state, and parties are not free to vary significantly from the statutory formulations. LLCs, by contrast, are creatures of contract, and have great flexibility for both the financial and the governance terms in the LLC Agreement, none of which is required to be filed of record. The dark side of this creativity is that the lack of uniformity and public access make it more difficult to render a meaningful legal opinion.

Consider the example of capitalization. Any complicated corporate capital structure will be formulated in a preferred stock designation filed of record with the secretary of state, and the terms and conditions permitted in those designations are set out in the applicable state statute. The comparable capital structure in an LLC is found in the LLC Agreement, and there is no statutory formulation (save the constrictions of US federal income tax law) that provides boundaries or architecture for the formulations. Thus, any opinion about the capitalization of an LLC requires an opinion on state contract law.

Finally, even the publicly available materials, there is not uniformity. The differences among state statutes are not small or subtle, and state variations make opinion giving more difficult. For example in Delaware, there is no requirement in the Delaware LLC statute that the LLC state of public record whether or not it is member managed or manager managed. This is a very basic fact that affects almost all of the basic LLC entity legal opinions, including formation, due authorization and enforceability. Because of the great contractual flexibility of LLC structures, the non-uniformity of statutes, and outright dearth of public statutes and filings, the tasks for an opinion giver are markedly different in the LLC practice.

## II. GENERAL PRINCIPALS OF OPINION PREPARATION AFFECTED BY THE CHANGING LLC ENVIRONMENT

The American Bar Association and our own State Bar of Texas have established committees that prepare both general principals to guide opinion preparation and delivery, and specific opinion language that is intended to convey specific and detailed meanings. The American Bar Association intends for these general principals and formulations to create a common ground among lawyers to give deep and meaningful context to the few sentences contained in the basic legal opinion. For LLCs, however, there is still much room for the creation of common ground. Due to their relative newness, sparse case law and historical context, and the significant lack of uniformity across state lines, the "common ground" is a work in progress. Customary practice is being created here and now, which means that any one attorney's practice may not be so "customary," even if that is always the way it has been done before.

Examples abound. In Texas, the concept of "governing persons" is more pointed, defined and narrow than the statutory equivalent in Delaware, and the statutory flings in Delaware will not tell you the properly authorized agents, while in Texas, you have

some idea of who is the proper agent. What is customary practice to determine who is the proper agent for the LLC? It is as though we have the first thirteen year-old, and there has never been a fourteen year-old, and we want to really on customary practice for all teenagers. While I do not have a specific to do list, or bullet proof formulation, we must be alert about questioning our assumptions, and not rely on habits. At a minimum, where LLC law and practice is significantly divergent from corporate law and practice, we need to examine the "customary practice" for applicability in a new context, and carefully weigh the reasons underlying the custom.

The second area where caution needs to be applied is with knowledge qualifiers. While all of us have rendered and received opinions with knowledge qualifiers, knowledge becomes a more pointed issue in the contractually based LLC structure. In the Supplement No. 4 to the Report of the Legal Opinions Committee Regarding Legal Opinions in Business Transactions: Statement on ABA Principles and Guidelines from the Legal Opinions Committee of the Business Law Section of the State Bar of Texas, dated April 20, 2009, the Committee states as follows:

> "the phrase "to our knowledge" is historically understood by Texas attorneys to refer to the conscious awareness of facts and information of those attorneys actively involved in the transaction or in rendering the legal opinion, without have made any inquiry."

Because of the contractual nature of the LLC, the duty of inquiry with respect to any LLC cannot be the same duty of inquiry as with respect to a corporation and deliver the same substance in a legal opinion, because of the lack of public records and ability to craft specialized structures in the LLC context. If the LLC agreement is contractual by nature, the LLC Agreement must be read, and if read, and contains conditions, a knowledge qualifier has additional significance. With the knowledge qualifier provided by the Texas Bar, the above formulation does not give the opinion recipient the same level of comfort in the LLC opinion as that opinion would deliver in a corporate law opinion. The knowledge qualifier is a particular issue in an enforceability opinion for the LLC Agreement itself, particularly if the LLC Agreement contains any complexity about its capitalization or governance. If there are conditions or circumstances that would require verification outside the four corners of the LLC Agreement, what is the correct boundary for the knowledge qualifier?

The issues surrounding the knowledge qualifier also serve to highlight the issue of "customary" in the LLC world. In the context of an LLC, a careful explanation of the depth and nature of the inquiry made in connection with rendering the normal opinions and related knowledge qualifiers may be appropriate, even if such cautionary language has not been or is not currently "customary." At a minimum, one should be clear in any LLC opinion with any complexity of capital or governance structure about what documents and records you in fact reviewed, and what further inquiries you may have made, and describe what you assumed without inquiry.

Finally, choice of law questions are magnified in the LLC practice. Historically (and I do **not** say customarily) significant portions of the standard entity opinions may be reliably rendered in the corporate opinion based upon the state statute and the documents filed of record. The LLC Agreement, however, can go far beyond the enabling statute. The converse is also true, when an LLC Agreement is sparse, and the statute does not directly cover the issue, so that the proper response to a basic question is ambiguous. This magnifies the importance of local contract law. The ABA has cautioned lawyers to consider whether their knowledge of another jurisdiction's law on contract, which becomes the primary governing law in LLC opinions, is sufficient to render the opinion. Reliance on the LLC statute alone will not be adequate. While I believe that over time, this need to rely on local contract law may change as practice becomes more uniform, currently, local law is much more important in the LLC context.

One striking example of this contractual issue is the concept of good faith and fair dealing. Delaware statutory law has the concept that parties to a contract, including an LLC Agreement, must meet a minimum standard of "good faith and fair dealing." With respect to LLCs, this is found in the Delaware LLC Act in Section 18-1101(c). Even though the Delaware Act allows for the elimination of fiduciary duties in an LLC Agreement, Delaware Act the company agreement may not eliminate the implied contractual covenant of good faith and fair dealing. By contrast, Texas case law provides that there is no general standard of good faith and fair dealing in contracts generally, *Formosa Plastics Corp USA v. Presidio Engineers and Contractors, Inc.*, 960 SW 2d 41 (Tex 1998), unless there is unequal bargaining power between the parties and the weaker party requires protection, *Subaru of America, Inc. v. David McDavid Nissan, Inc.*, 84 SW 3d 212 (Tex. 2002). Under Texas LLC law, conversely, fiduciary duties may not be eliminated, but only may be restricted. Thus, an enforceability opinion for a Delaware LLC by a Texas licensed lawyer will have to account for the Delaware contract case law, not just the Delaware LLC statute, and the analysis is fundamentally different from the analysis under the Texas rules. There are a myriad of other examples, but

it should be sufficient to say that caution must be exercised in the choice of law area.

One common solution, and a solution generally proposed by the ABA Guidelines in order to reduce the costs, is for the lawyer rendering the opinion about an entity formed in another state to render the opinion as if the law of the state in which the lawyer is licensed is applied. Thus, a Texas lawyer would render an opinion on a Delaware LLC, based on the assumption that Texas LLC law applies. Given the differences in contract laws across the states, with the "good faith" example described above, I would ask if that solution is truly viable or even acceptable for an LLC opinion. Given the several significant differences, this could be an opinion practice that misses a significant issue, especially in the context of an opinion on enforceability of a contract. I would simply point out that choice of law issues in the LLC context are currently much more difficult than opinion givers have historically had to contend with in the corporate context.

## III. LEGAL OPINION FORMS AND REQUIRED ACTIONS.

With the general issues in the forefront of our analysis, we can turn to specific opinion language and related practice on what the attorney should read and check in order to give that opinion language. I will discuss the five basic transactional legal opinions, formation and existence, power, due authorization, fiduciary duties and enforceability.

### A. Formation and Existence.

The traditional language of "duly incorporated" must change in the LLC context. The standard that seems to be taking effect is the following formulation:

> "The Company has been duly formed and validly exists as a limited liability company in good standing under the [Act]."

"Act" refers to the LLC statute that governs that LLC, and in Texas, we would likely say "TBOC." What are the tasks that must be completed to render this opinion? Obtain and the file stamped certificate of formation from the applicable Secretary of State, and obtain and review the fully executed LLC Agreement and all amendments thereto.

The unique issues for LLC formation in this opinion include (i) the existence of a written LLC agreement, (ii) the existence of at least one member, (iii) confirmation of conditions to becoming a member, especially confirmation of capital contribution requirements, and (iv) confirming that the LLC has not been dissolved.

One issue of sensitivity in all LLC statutes is the issue of the written LLC Agreement. If an LLC is a creature of contract, there has to be an LLC Agreement for it to properly exist. All states have "soft" language around this contract formation issue since even the drafters of statutes recognize that clients have regularly failed to prepare or execute written agreements. Notwithstanding that statutes permit oral and implied agreements, if your opinion is in issue, insist on a written LLC Agreement. Further, the LLC Agreement is best structured to require that it be executed by each member and the LLC itself.

An LLC must have members to be duly formed, and the LLC statute requires that the LLC have at least one member. There are several LLC law nuances in this issue. First, is the issue of the single member LLC, and how a single member can enter into a contract. While the esoteric side of this issue intrigues, I solve the problem by making each LLC as an entity execute the LLC Agreement with the sole member, and that way I always have two parties to the contract. Second, under Delaware law, you can have an LLC with only a "non-economic" member, Section 18-301(d), which is not a member sufficient to be duly formed, so you have to make sure in Delaware that you have a "true" member for the entity. Under Texas law, you may not have an LLC with only an economic member. The Texas statutory formulation requires that the non-economic member be in addition to at least one true member, TBOC Section 101.102(c).

Conditions to becoming a member is one of those significant contractual, factual issues that you must seriously consider. First, there may be conditions set forth expressly in the LLC Agreement for the acquisition of the LLC Interest, most notably, the contribution of capital. There may be other conditions about the nature of the members in addition to issues of capital contributions. Further, there may be, or may have been, an "Interest Purchase Agreement" or "Subscription Agreement" with further conditions to the issuance of the interests. Unlike a share of stock, where you may check the director's action to issue it, the issuance of the LLC interest is governed by contract law. If you are in possession of the facts, lucky for you. The importance or difficulty of this issue will also depend on the transaction. I can imagine a situation where an LLC has a complex capital structure, that requires approval from the existing members to issue more interests, and there is an opinion required of the lender to the LLC for the debt portion of the transaction. The existing capitalization will require due diligence and examination to give the basic formation opinion. This is a major area of the importance and scope of knowledge qualifiers, since there may be many conditions in a subscription agreement that must be confirmed that would not be contained in the four corners of the LLC Agreement.

If you are in a more complex situation, there are several actions that may ameliorate the risks. First, consider adding a certificate from an officer giving the representations that you would need to confirm that the conditions are being or were met or waived, or that there are no conditions outside of the LLC Agreement itself. Second, the ABA has suggested the following reservation:

> "they may state in their opinions that they have not reviewed any documents other than those listed, and that they assume no provision or document exists that they have not reviewed that is inconsistent with the opinions they are giving, and that they have not conducted an independent factual investigation, but have relied solely on the documents listed, all of which they assume to be true, complete and correct in all material respects."

This type of reservation ties in nicely to a corresponding officer's certificate, stating that these assumptions are in fact accurate. Again, because of the factual issues, and contractual basis of the LLC Agreement, the duty of inquiry and related knowledge qualifiers are more significant than has traditionally been the case in corporate opinions. Of note, one is not required to make sure that the member itself is duly organized. Thus, if one of your members is an entity, you do not have to verify that the entity/member is duly formed.

Finally, in the formation opinion, one must consider the issue of the potential dissolution of the LLC. Even though there is a certificate of formation on file with the Secretary of State, it is factually possible for the LLC to have been dissolved in accordance with the terms of its LLC Agreement and also by operation of statute, without the time to have filed the certificate of termination. Again this is an issue unique to LLC and partnerships that does not have an equivalent in corporate law. Issues of potential dissolution include (i) LLCs being formed for a term (which is not apparent on a Delaware certificate of formation), (ii) being formed for a purpose, and the purpose having been completed, (iii) a condition for the existence of the LLC or the ownership of the LLC Interests having failed or not been completed, or (iv) a point in time where there was no member past the deadline in which "memberlessness" could be rectified under the statutory procedures. Secondly, in Texas especially, the taxing authorities take their actions to dissolve an entity prior to the time it is recorded in the Secretary of State, so we are always required to check with the franchise tax authorities in addition to the Secretary of State. Solutions for the issues of dissolution include the same solutions as those for other conditions discussed above, namely checking the basic constituent documents, and if necessary, using an officer's certificate and appropriate reservations in the actual opinion.

**B. Power.**

The power opinion in the LLC context has evolved to the following language:

> "The Company has the limited liability company power to execute and deliver the [XXX] Agreement [and to issue and sell the LLC Interests] and perform its other obligations thereunder."

Once you have done the work to render the "formation" opinion, the "power" opinion derives from the proper existence of the LLC itself. Once is it properly formed, except for those types of transactions that cannot be accomplished by a general state entity (banking, etc.), the LLC has the power to enter into a transaction. One cautionary note, however, just like the case for a corporation, even if the minimum pre-requisites for formation have been met, the power to contract does not mean that all provisions of the LLC Agreement are automatically enforceable. Stated another way, an LLC may be formed and be able to enter into contracts, including the LLC Agreement itself, but not all parts of the LLC Agreement may work, or work together. An opinion on power is an opinion that the company is able to take an action, not an opinion that it has properly taken all the steps to take that action (see "Due Authorization," below).

1. Due Authorization.

The formulation for the due authorization opinion in the LLC context reads as follows:

> "The Company has duly authorized, executed and delivered the [XXX] Agreement, and the [XXX] Agreement constitutes a valid and binding obligation **enforceable** discussed below] against the Company in accordance with its terms."

This language encompasses due authority and enforceability, and I will discuss enforceability in more detail below. Remember, the language set forth above, is the actual opinion, and the customary practice (not affected by any LLC practice) is to qualify this opinion by issues such as equitable relief and bankruptcy. The traditional exception language is found in the ABA materials. There is also a discussion about the traditional assumption that this opinion does not include an opinion on fraudulent conveyances, and since this discussion has not been altered by any LLC

practice, I suggest you refer to the ABA materials if you need further information.

After consideration of the traditional exceptions, the "due authorization" opinion is derived from the "formation" opinion and the "power" opinion, and adds to these opinions the concept that the company has properly taken all steps to enter into the agreement and that an actual agent (within the meaning of agency law) has executed and delivered the agreements in question. This opinion is another area where the LLC flexibility and ability to make contracts cause the opinion giver to carefully review the underlying contracts. The LLC Agreement will generally govern any procedures for the entry into a contract. If the LLC Agreement is silent, each state has default provisions (although this is another area of differences among states). If there are special procedures required by the LLC Agreement (e.g. supra majority votes of members or managers), you must check to see if they have been followed, and obtain in writing that such approval has been obtained. Generally, the issue of actual authority may only be solved by the review of the LLC Agreement. Delaware has no filing that would name a person with actual authority. While the Texas certificate of formation names members of a member managed or managers of a manager managed, you may not completely rely on the state filing, because the statute permits restrictions and variations, and such variations are more common than not. Thus the issue of actual authority may only be solved by reading the LLC Agreement (and any documents to which it may point). One must use all of the steps for review as set forth in "formation," above, that is obtain and review the certificate of formation and LLC Agreement, but this is also an area where it is very customary to obtain a certificate (e.g., an incumbency certificate).

2. Fiduciary Duty Issues.

Most closing opinions do not require an express opinion that the actual agents have acquitted their fiduciary duties. Notwithstanding, the ABA, in its General Principals, does state that while you may assume fiduciary duties (as they may exist) hare being completed, you may not make that assumption if actual facts come to your attention, that in light of applicable case law, would cause you to question that assumption. The types of facts that can give rise to this query are (i) self-dealing, (ii) disparate cash distributions, or (iii) bad conduct by the decision makers. The ABA reminds us that we cannot further or assist in wrongful conduct of our clients, and if you have concerns about the bad conduct of any decision maker, the ABA Guidelines do not permit the opinion giver to rely on any exculpatory language that may exist in an LLC Agreement.

3. Enforceability.

Enforceability is the area in which the LLC practice has caused the most thought and writing on the proper legal opinions, that is, the issues surrounding the enforceability of the LLC Agreement itself. In the corporate context, if one is purchasing stock, the constituent documents include the publicly filed certificate of formation and the related authorization of the issuance of that stock by the Board of Directors. By contrast, investment in LLC Interests is based on the LLC Agreement, a contract, so that what is the corporate world is a relatively simple opinion based on statutes and public filings (shareholder agreements aside), is a complicated contractual enforceability opinion in the LLC context. I have discussed in some detail at the start the sensitivity in legal opinions on LLCs in the choice of law area, and this choice of law issue is very important in the enforceability opinion. Enforceability opinions for LLCs quickly turn to issues of state contract law, rather than the LLC statute itself. Because of the heightened issues in the LLC practice, the ABA has published a supplement to its original LLC Report, the "Supplemental Report on Membership Interests, to address the enforceability issues in rendering an opinion on the enforceability of the LLC Agreement itself, and the issuance of interests to investors in the LLC.

In this report, the ABA outlined major topics that are generally required to be covered in this area, including creation of the LLC Interest, issuance of the LLC Interest, consideration and payment for the LLC interest, obligations to make future capital contributions as a result of the ownership of the LLC and admission as a member of the LLC. In addition to the ABA, several states, including Texas, (in comments to the ABA provisions) Massachusetts and California, have also weighed in with state by state commentary on the enforceability issues unique to that state. It is important here to especially recognize the non-uniformity of both the LLC law and contract law of each state, so that commentary to craft provisions sounded in the state statutory structure is vital.

**C. Valid Issuance of the Interests, No Further Liability and Limited Liability.**

The current formulation for the opinion on valid issuance is as follows:

> "Upon issuance and sale to the Purchasers in accordance with the Purchase Agreement, the LLC Interests will be validly issued, and, under the [Act], the Purchasers will have no obligation to make further payments for their purchase of LLC Interests or contributions to the Company solely by reason of their ownership of LLC Interest or their status as members of the Company [, except as

> provided in their Purchase [Subscription] Agreement or the LLC Agreement in Sections ___, ___ and ___ thereof] ."

This paragraph contains two separate opinions, that there has been a valid issuance and that there are no further payments due with respect to the interests, which is the LLC equivalent of the corporate formulation of "fully paid and nonassessable." Turning to the "validly issued" opinion, this opinion derives directly from the LLC having been properly formed, as set forth in the first paragraph of the opinion, and thereafter, that the conditions for issuance of interests as set forth in the applicable state statute and in the LLC Agreement have been met. The opinion confirms that the terms of the interests do not violate the state statute or the LLC Agreement, and the conditions set forth in the statute for the issuance of interests and the related terms in the LLC Agreement. In LLC practice, the issues and analysis presented by these requirements are markedly different from the issues and analysis in a corporate opinion.

To render this opinion, the basis of the proper formation of the LLC must be confirmed. Next the state statute, concerning issuance of interests must be satisfied. The nature and form of consideration acceptable for issuance of interests varies among the state statutes. Additional issues in LLC practice stem from the variety of conditions under which interests may be held. Persons holding interests may not be admitted as members of the LLC, or state conversely, you have the possibility of acquiring a bundle of rights that is less than all of the rights associated with full membership in the LLC. If you were issued interests with only economic rights, or only management rights and no economic rights, would those interests be validly issued? The answer is likely to be yes, even though there is not a full bundle of rights. Under an LLC Agreement, or a related subscription or purchase agreement, the issuance of the interests may be subject to conditions that must be verified. Just as in the corporate world, it is common to issue interests for something other than property (i.e. services) and in the world of carried interests, it is often a promise to render services in the future. Other common conditions to issuance are limitations on the percentage interest that may be held by any one constituent (i.e. a class may no hold more than 50% of the interests), or limits on the status of the member (i.e. a member in this class may only be an employee). The conditions of concern, however, are those that must be satisfied at the moment of issuance, not those that are ongoing covenants during the life of the LLC. The ABA guidelines state that the opinion on "valid issuance' does not speak to the enforceability of the terms of the interests themselves, and that matter is to be opined on, if at all, in another section of the opinion. Further note that in the LLC practice, the "corporate" concept of "duly authorized" stock is simply not applicable. LLC do not have the statutory concept of "authorized interests", and this is a concept and phrase that simply does not apply outside corporate practice.

**D. Obligations for further payments.**

In the corporate world, once valid consideration has been paid (in full) for the stock, no further amounts are owed. Because of the contractual nature of the LLC, one must carefully read the LLC Agreement and consider the contractual and tax provisions around the amounts due for the interests. One obvious issue is that it is not uncommon for the LLC interests to be issued pursuant to a subscription, in which there are payments over time in the future. Upon initial issuance, additional payments would be due, and this opinion language would have to be clarified.

The LLC opinion contains a qualifier of "solely by reason of ownership of the interest," and this qualifier is intended to indicate, once again, that you may own an interest, but you may not be admitted as a member. It is not clear that an owner of an economic interest only would be liable for further capital contributions. The qualification "under the "Act [in Texas, the TBOC]" is meant to convey that there are federal laws under which an owner of an interest could have monetary liability with respect to that interest. Additionally, there may be laws in other states that would affect that opinion, as for example if you were opining about a Texas Series LLC in a state in which there is no Series LLC legislation. It is not clear that the separateness of the Series in the LLC would be respected in another state that does not have series statutory authority.

With respect to the exception on wrongful distributions, this form of opinion is based on the very specific Delaware statutory language, which is the Delaware provision on eliminating the member's personal liability, which starts with the qualifier as follows:

> "Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member of manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company."

The Delaware LLC Act provides that members must return distributions of cash made in violation of the

statute, and therefore, members may have a potential personal liability created by the statutory formulation that is not present in other state law provisions. I point out that this particular issue is also true for dividends on capital stock in corporations, and the traditional language in corporate practice has used a similar exception, although the corporate liability is clearly an "in rem" liability, so the stock holder must return the dividend, but is not otherwise personally liable. The statute in Texas, Section 101.114 of the TBOC, states as follows:

> "Except and to the extent that the company agreement specifically provides otherwise, a member or manager is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or other order of a court."

Caution would lead one to leave the exception in for wrongful distributions, unless and until there is a legislative or judicial clarification of the issue (that would indicate you could delete it).

Due diligence for this opinion requires the attorney to confirm that the person to whom the interest was sold pay the consideration required in the LLC Agreement, and any applicable subscription or purchase agreement. Thus, in addition to a review of the LLC Agreement, you must document the transfer of the required consideration.

1. Personal Liability.

The opinion that a member had no personal liability springs from the initial days of LLC formation when person on the other side of the transaction wanted confirmation of the nature of the limited liability afforded the members. While this this opinion is common, this is one area where there has been case law addressing the issue of personal liability of members and confirming the limited liability of the member in the status of member. The robust LLC case law on veil piercing has established the limited liability of member, although this opinion persists.

One significant area for all entities taxed as partnerships under federal tax law is the obligation to restore negative capital accounts. First, aside from federal tax law, there are states (like Texas) that require partners to restore negative capital accounts in the state statute. The TBOC does not have a negative capital account make up provision for LLCs, it only applies to partnerships, but if you are in other states, it is wise to check the applicable state provisions. Under federal tax law, there is potential for liability. Under this particular formulation of the opinion, the opinion is limited to the state statutes, so the federal tax issue is expressly excluded from the opinion. Caution would dictate, again, that this exclusion be made quite clear in the exceptions provisions of the opinion, and remember to always check the tax issue for your client.

2. Admission as a member.

If you are asked to opine on membership, the following is an example of common language:

> "Each Purchaser has been duly admitted as a member."

Issues concerning admission as a member are separate and apart from the issues of payment of the consideration for the interest. Once again, you may pay consideration for the interest and not become a member, or be a member with a noneconomic interest. To become a member of an LLC, you must meet the conditions set forth in the applicable LLC statute, and the conditions set forth in the LLC Agreement. Conditions for admission vary depending on when and how a person acquires the interest, and admission upon formation is different from admission upon transfer. Questions of admission must also be affirmatively answered in mergers, or in Delaware, in domestications. The statutory rules in Texas for admission, of course, differ from the statutory admission rules in Delaware. Specifically, in Delaware, it is possible to have a single member LLC with a member that does not have an economic interest, which means that there can be a member in Delaware that will not be entitled to allocations and distributions. Specifically, Section 18-301(d) of the Delaware Act (which applies to an LLC with only one member) states as follows:

> "A person may be admitted to a limited liability company as a member of the limited liability company and may receive a limited liability company interest in the limited liability company without making a contribution or being obligated to make a contribution to the limited liability company."

Texas, by contrast, in Section 101.102(c),has the following statutory formulation:

> "If one or more persons own a membership interest in a limited liability company, the company agreement may provide for a person to be admitted to the company as a member without acquiring a membership interest in the company."

This language requires at least one member to have an economic interest, and does not permit non-economic members to be the sole member in an LLC.

Generally, the opinion on admission only covers the LLC statute and the LLC Agreement itself, and does not require that you confirm conditions that may be set forth in a subscription or purchase agreement. As a result, many LLC Agreements contain the conditions for admission, either directly, or incorporation by reference, in addition to the subscription agreement itself. If that is the case, the conditions will be swept into the opinion.

This opinion, further, is considered to mean that the LLC and its members may enforce the terms of the LLC Agreement against the admitted member, and that the member itself has the power to become a member under the law under which that admitted member was formed.

## IV. CONCLUSION

Issuing an opinion on the formation and capitalization of an LLC requires thoughtfulness about the statutory and contractual nature of the LLC. Because the LLC statutes rely heavily on the right and ability of the parties to craft their own contractual provisions around governance and capitalization, fundamental opinions, such as enforceability, have a different analysis and due diligence than has historically been the case for corporate law opinions. As lawyers, we have worked to establish procedures, i.e. "customary practices" for opinion giving, but in the LLC world, simple reliance on custom is not a recommended practice. The LLC has not been in existence long enough for the custom to be as developed as in the corporate world. Further, the dual issues of statutory variance and the primacy of contractual law in an LLC Agreement change the analysis and related due diligence task, as well as increase the focus on factual assumptions and knowledge qualifiers. While the bar has developed a relatively standard legal opinion format, the actual meaning and legal effect of the transactional LLC opinion may vary from its traditional counterpart, simply from the ways in which the bar has suggested that the issues of contractual matters be addressed. I would suggest that continued sensitivity to these issues will be important for the foreseeable future.