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Opening a Restaurant in New York City: Legal Issue Bootcamp

Andreas Koutsoudakis, Esq.
Koutsoudakis & Iakovou Law Group, PLLC ("KI Legal")

Corporate Considerations Supporting Documents:

1. **Corporate Considerations: Entity Comparison Charts**
2. **Shareholder Agreement Checklist (NY)**
3. **Operating Agreement Checklist (NY)**
4. **Best Practices in Corporate Subsidiary Management**
5. **Key Negotiation Points in Private Acquisition Agreements Comparison Chart**

1.
CORPORATE CONSIDERATIONS:
Entity Comparison Charts (NY)

There are many different issues to consider when choosing the appropriate business entity and this Chart covers many of the most common ones. Determining which type of entity to choose also depends on the intended purpose of the entity (for example, to make an acquisition).

This Chart provides a comparison of the differences among the following New York for-profit entities:[1]

- **C-corporations**.
- **S-corporations**.
- **Limited liability companies** (LLCs).
- **General partnerships** (GPs).
- **Limited partnerships** (LPs).

Initial Considerations

Tax Issues

This Chart addresses only some general aspects of US federal income tax law. The tax consequences of selecting an entity are complex and vary depending on factors such as:

- The type of business conducted.
- The entity's ownership structure and composition.
- Tax laws of the jurisdiction of formation and the jurisdictions in which the entity does business.

It is assumed that the LLCs discussed in this Chart will be treated as partnerships or disregarded entities for US federal income tax purposes because that is the most common classification for LLCs. Taxation of Partnerships.

State tax information is available from the New York State Department of Taxation and Finance (NYS Tax Dept.). For entities planning to operate in New York City, city tax information is available from the New York City Department of Finance. Parties should consult a tax specialist familiar with local and federal tax issues before forming an entity.

Employee Benefits and Regulatory Concerns

The entity form selected may also affect the types of retirement plans, health and welfare plans, and other employee benefits that can be offered to employees and business owners. A full explanation of these matters is outside the scope of this Chart so the parties should consult an employee benefits attorney.

If the entity will engage in a business that requires licensing or in a regulated industry, the organizers should also consult counsel who specialize in matters affecting the particular business or industry before forming an entity. Information about licensing New York businesses is available from the New York Department of State Division of Licensing Services.

[1] This Chart focuses on the laws of New York business entities. If forming an entity in a different state, consult the appropriate state statutes before finalizing the choice of entity.

New York Statutes

In New York, the formation and operation of the entities described in this Chart are governed by:

- The New York Business Corporation Law (NYBCL §§ 101 et seq.).
- The New York Limited Liability Company Law (NY LLCL) (NY LLCL §§ 101 et seq.).
- The New York Partnership Law (N.Y. P'ship Law §§ 1 et seq.).
- The Revised Limited Partnership Act (Revised Act) (N.Y. P'ship Law §§ 121-101 et seq.).

Depending on an entity's date of formation, specific sections or different amendments of the relevant act may apply. For example, New York LPs formed after September 30, 1919, and before July 1, 1991, are governed by the Uniform Limited Partnership Act (N.Y. P'ship Law §§ 90 et seq.) unless they elect to be subject to the Revised Act (N.Y. P'ship Law §§ 121-1201 and 121-1202). Earlier versions of certain sections of the NY LLCL apply to LLCs formed before August 31, 1999, unless their operating agreements provide otherwise (see, for example, NY LLCL §§ 206(b)(6), 402(g), 606(b), 701(c), 1002(h), and 1006(i)). All statutory citations and information in this Chart assume the entities being compared are newly formed.

See below for:

- Ownership Requirements Chart
- Form of Equity and Transfer Restrictions Chart
- Required Organizational Filings and Filing Fees Chart
- Governing Documents Chart
- Liability Chart
- Management Chart
- Fiduciary Duties Chart
- Employee Incentives Chart
- Capital Raising Considerations Chart
- Distributions Chart
- Other Considerations Chart

Ownership Requirements

C-Corporation	**S-Corporation**	**LLC**	**GP**	**LP**
One or more shareholders. No restrictions on the types of owners.	One to 100 shareholders. Members of a family and their estates are treated as one shareholder (IRC § 1361(c)(1)). With limited exceptions, only US individuals (citizens or residents) and certain trusts and tax-exempt organizations can be shareholders. Only eligible US entities can make an S-corporation election (generally a US C-corporation or other US business entity eligible to elect C-corporation tax status) (IRC § 1361(b)). An S-corporation automatically converts to a C-corporation if it does not meet the requirements of an S-corporation (meaning, no more than 100 shareholders, only specific types of shareholders, and only one class of shares) (IRC § 1362(d)(2)).	One or more **members** (NY LLCL § 203(c)). To be taxed as a partnership, two or more members are required (Treas. Reg. § 301.7701-3). No restrictions on the types of owners (NY LLCL §102(q), (w)).	Two or more **partners** (N.Y. P'ship Law § 10(1)). A partner can be an individual, partnership, corporation, or other association (N.Y. P'ship Law § 2).	At least one **general partner** and at least one **limited partner** (N.Y. P'ship Law § 121-101(f)-(h)). A general partner may also be a limited partner (N.Y. P'ship Law § 121-404). No restrictions on the types of owners (N.Y. P'ship Law § 121-101(n)).

Form of Equity and Transfer Restrictions

C-Corporation	**S-Corporation**	**LLC**	**GP**	**LP**
Capital shares issued. Multiple classes of shares (usually **common shares** and **preferred shares**) with different rights and preferences between them are permitted. Shares are transferable according to law and the **by-laws** (NYBCL § 508(d)). The **certificate of incorporation**, securities laws, shareholders' agreements, or other agreements (such as a **lock-up agreement** with an underwriter) may contain additional transfer restrictions. Transfers may be subject to registration under state and federal securities laws.	Capital shares issued. Only one class of shares is permitted. Differences in voting rights among common shares are permitted. (IRC § 1361(b)(1)(D), (c)(4).) Certain debt instruments, **call options**, **warrants**, or similar instruments may be treated as a second class of shares under S-corporation rules. (IRC § 1361(c)(5) and Treas. Reg. 1.1361-1(l)(4).) Shares are transferable in accordance with law and the by-laws (NYBCL § 508(d)). The certificate of incorporation, securities laws, shareholders' agreements, or other agreements (such as a lock-up agreement with an underwriter) may contain additional transfer restrictions. Transfers may be subject to registration under state and federal securities laws.	**Membership interests** issued. Multiple classes of membership interests with different rights and preferences between them are permitted (NY LLCL § 418(a)). Economic rights of membership interests are freely transferable but voting and management rights are not unless the operating agreement provides otherwise (NY LLCL § 603(a)).	Each partner holds partnership interests. All partners are general partners. Partners have three types of property rights: • Rights in specific partnership property. • **Profits interests**. • Management rights. (N.Y. P'ship Law § 50.) Profits interests are transferable but assignee does not become a partner unless all the other partners consent (N.Y. P'ship Law §§ 40(7), 52, and 53).	Each partner holds partnership interests. Multiple classes of both limited and general partners with different rights are permitted (N.Y. P'ship Law §§ 121-302(a) and 121-405(a)). Partnership interests are freely assignable personal property, unless restricted by the **partnership agreement** (N.Y. P'ship Law §§ 121-701 and 121-702(a)). Unless the partnership agreement provides otherwise, an assignee receives the right to **distributions** and **allocations** of profits and losses only and does not have liability as a partner until the assignee becomes a partner, but only to the extent assumed by agreement (N.Y. P'ship Law § 121-702(a)(3), (c)). Transferee of a partnership interest (including a general partnership interest) may become a limited partner if granted by assignor according to partnership agreement, with the consent of all partners, or as

				otherwise provided by the partnership agreement (N.Y. P'ship Law §§ 121-301(b)(2) and 121-704). General partners may be admitted with written consent of all partners or as provided in the partnership agreement (N.Y. P'ship Law § 121-401).

Required Organizational Filings and Filing Fees

C-Corporation	**S-Corporation**	**LLC**	**GP**	**LP**
Certificate of incorporation filed with the New York State Department of State (DOS) (NYBCL §§ 402 and 403 and see Standard Document, Certificate of Incorporation (NY)). $125 filing fee (NYBCL § 104-A(d)).	Same as C-corporation, except must also make federal and state S-corporation election tax filings. An eligible US entity makes a timely federal S-corporation election on **Internal Revenue Service** Form 2553 no more than two months and 15 days after the beginning of the tax year the election is to take effect. A New York corporation that is a federal S-corporation may elect to be a New York S-corporation if it meets certain New York State requirements (see Other Considerations).	Articles of organization filed with the DOS (NY LLCL §§ 203 and 209 and see Standard Document, Articles of Organization (NY)). $200 filing fee (NY LLCL § 1101(f)). Certificate of publication, with affidavits of publication, filed with the DOS (NY LLCL § 206). $50 filing fee (NY LLCL § 1101(s)).	Certificate filed in the county clerk's office in each county where the partnership conducts business stating, among other information, the partnership's and the partners' names and addresses (N.Y. Gen. Bus. Law § 130(1)(a)). $100 filing fee in counties within New York City and $25 in all other counties (N.Y. Gen. Bus. Law § 130(5)(a)(1) and CPLR 8021(b)(2)).	**Certificate of limited partnership** filed with the DOS (N.Y. P'ship Law §§ 121-201 and 121-206). $200 filing fee (N.Y. P'ship Law § 121-1300(e)). Certificate of publication with affidavits of publication filed with the DOS (N.Y. P'ship Law § 121-201(c)). $50 filing fee (N.Y. P'ship Law § 121-1300(f)).

Governing Documents

C-Corporation	**S-Corporation**	**LLC**	**GP**	**LP**
Certificate of incorporation and by-laws (NYBCL §§ 402 and 601 and see Standard Documents, Certificate of Incorporation (NY) and By-Laws (NY)). Shareholders may also enter into shareholders agreements, **voting agreements**, and **voting trust** agreements (NYBCL §§ 620 and 621).	Certificate of incorporation and by-laws (NYBCL §§ 402 and 601 and see Standard Documents, Certificate of Incorporation (NY) and By-Laws (NY)). Shareholders may also enter into shareholders agreements, voting agreements, and voting trust agreements (NYBCL §§ 620 and 621).	Articles of organization and written operating agreement (NY LLCL §§ 203 and 417). See Standard Documents: • Articles of Organization (NY); • Operating Agreement (Single Member) (NY); • Operating Agreement (Multi-Member, Member-Managed) (Short Form) (NY); • Operating Agreement (Multi-Member, Manager-Managed) (Short Form) (NY); and • Operating Agreement (Multi-Member, Manager-Managed) (NY).	Partnership agreement. A written partnership agreement is permitted (and common) but not required. A partnership can exist based on the parties’ conduct, intent, and relationship, without a written agreement (*Tabibnia SRL v. Khaledi Oriental Rugs, Inc.*, 80 N.Y.S.3d 23, 24 (1st Dep’t 2018)).	Certificate of limited partnership and partnership agreement (N.Y. P’ship Law §§ 121-110, 121-201, and 121-206). A written partnership agreement is required. General partners must sign and limited partners may but are not required to sign. (N.Y. P’ship Law § 121-110(a), (b) and 121-201(a).)

Liability

C-Corporation	S-Corporation	LLC	GP	LP
Shareholders are generally not liable for corporation's obligations (*Vivir of L I, Inc. v. Ehrenkranz*, 43 N.Y.S.3d 435, 437 (2nd Dep't 2016)). Shareholders are obligated to corporation for their unpaid contributions (NYBCL § 628(a)). A shareholder's liability is generally limited to the amount of capital contributed. The ten largest shareholders (other than of public and investment companies) are personally liable, **jointly and severally**, for the corporation's unpaid wages (NYBCL § 630). Criminal liability may be imposed on the corporation and its officers and agents for not paying wages (N.Y. Lab. Law § 198-a).	Shareholders are generally not liable for corporation's obligations (*Vivir of L I, Inc.*, 43 N.Y.S.3d at 437). Shareholders are obligated to corporation for their unpaid contributions (NYBCL § 628(a)). A shareholder's liability is generally limited to the amount of capital contributed. The ten largest shareholders (other than of public and investment companies) are personally liable, jointly and severally, for the corporation's unpaid wages (NYBCL § 630). Criminal liability may be imposed on the corporation and its officers and agents for not paying wages (N.Y. Lab. Law § 198-a).	Except as provided in the operating agreement, members are obligated to LLC for their unpaid contributions (NY LLCL § 502). A member's liability is generally limited to the amount of capital contributed. Members and managers are not liable for the LLC's or each other's debts or obligations (NY LLCL §§ 409(c) and 609(a)). A member may be liable, however, as provided in the articles of organization, if the member either consented in writing to or voted for adoption of the provision (NY LLCL § 609(b)). The ten members with the most equity ownership are personally liable, jointly and severally, for the LLC's unpaid wages (NY LLCL § 609(c)). Criminal liability may be imposed on the LLC and its managers (or members in a member-managed LLC) for not paying wages the LLC owes (N.Y. Lab. Law § 198-a and NY LLCL §§ 401(b) and 412(a)).	Partners are jointly and severally liable for other partners' wrongful acts and misappropriation of third party funds or property and **jointly liable** for all other partnership obligations (N.Y. P'ship Law § 26). Criminal liability may be imposed on partners for not paying wages the partnership owes (N.Y. Lab. Law § 198-a).	General partners have the same liability as partners in a GP but the partnership agreement can limit their liability to the LP or other partners (N.Y. P'ship Law § 121-403). Partners are obligated to the LP for their unpaid contributions (N.Y. P'ship Law § 121-502). Limited partners are liable for the LP's obligations and liabilities if they are also general partners or share in the control of the business (N.Y. P'ship Law §§ 121-303(a) and 121-404). Limited partners that allow their names to be used in the LP's name are liable to the LP's creditors that did not know the limited partner was not a general partner (N.Y. P'ship Law § 121-303(d)). Criminal liability may be imposed on general partners (or limited partners involved in management of the LP) for not paying wages the LP owes (N.Y. Lab. Law § 198-a).

Management

C-Corporation	S-Corporation	LLC	GP	LP
Managed by a board of directors unless the certificate of incorporation states otherwise (NYBCL §§ 620(b) and 701). The board may elect officers to manage day to day operations (NYBCL § 715). The board may delegate certain responsibilities to committees (NYBCL § 712(a)). Shareholders must approve certain major business decisions (such as **merger**, sale of all or substantially all assets, and voluntary **dissolution** (NYBCL §§ 903, 909, and 1001)).	Managed by a board of directors unless the certificate of incorporation states otherwise (NYBCL §§ 620(b) and 701). The board may elect officers to manage day to day operations (NYBCL § 715). The board may delegate certain responsibilities to committees (NYBCL § 712(a)). Shareholders must approve certain major business decisions (such as merger, sale of all or substantially all assets, and voluntary dissolution (NYBCL §§ 903, 909, and 1001)).	Managed by members unless the articles of organization provide for managers (NY LLCL §§ 401(a) and 408(a)). The management structure is flexible and primarily determined by the members. Managers have the responsibilities set out by members in the operating agreement, subject to the articles of organization (NY LLCL §§ 203(e)(7), 408(a), and 417(a)). There is no statutory requirement to appoint officers but the operating agreement may provide for it (NY LLCL § 417(a)). Members must approve certain major business decisions, such as voluntary dissolution and merger (NY LLCL §§ 701(a)(3) and 1002).	Managed by all partners. Partners have equal rights in management subject to the partnership agreement. Every partner is generally an agent of the partnership for the purpose of its business. (N.Y. P'ship Law §§ 20 and 40(5).) The partners may delegate management and may (but do not need to) designate officers to manage day to day operations.	Managed by general partners. General partners have the same powers as a partner in a GP (N.Y. P'ship Law § 121-403(a)). Limited partners can exercise rights as a limited partner but participating in control of the LP will expand the limited partner's liability (N.Y. P'ship Law § 121-303). Subject to the partnership agreement, all general partners and a majority in interest of limited partners must approve certain major business transactions, such as voluntary dissolution and merger (N.Y. P'ship Law §§ 121-801(c) and 121-1102(a)).

Fiduciary Duties

C-Corporation	**S-Corporation**	**LLC**	**GP**	**LP**
Directors have **fiduciary duties** of **care** and **loyalty**. Directors must act in good faith and with the same level of care as an ordinarily prudent person in a similar position and circumstance (NYBCL §717(a)). The duty of care requires directors to act in an informed and reasonably diligent basis in considering material information (*Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 361 (Sup. Ct. N.Y. Co. 2005)). The duty of loyalty prevents directors from promoting personal interests that are incompatible with the corporation's interests (*Foley v. D'Agostino*, 248 N.Y.S.2d 121, 128-29 (1st Dep't 1964)). Under the business judgment rule, courts are barred from inquiring into directors' acts made both in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes (*Auerbach v. Bennett*, 419 N.Y.S.2d 920, 926 (1979)).	Directors have fiduciary duties of care and loyalty. Directors must act in good faith and with the same level of care as an ordinarily prudent person in a similar position and circumstance (NYBCL §717(a)). The duty of care requires directors to act in an informed and reasonably diligent basis in considering material information (*Higgins*, 806 N.Y.S.2d at 361). The duty of loyalty prevents directors from promoting personal interests that are incompatible with the corporation's interests (*Foley*, 248 N.Y.S.2d at 128-29). Under the business judgment rule, courts are barred from inquiring into directors' acts made both in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes (*Auerbach*, 419 N.Y.S.2d at 926). A corporation's certificate of	LLC managers (including **managing members**) have fiduciary duties of care and loyalty. Managers must act in good faith with the same level of care as an ordinarily prudent person in a similar position and circumstance (NY LLCL § 409(a)). Managers' actions are reviewed by New York courts under the business judgment rule (*Zuckerbrod v. 355 Co., LLC*, 979 N.Y.S.2d 119, 120 (2d Dep't 2014)). The operating agreement may limit or eliminate the liability of managers for subsequent breaches of their fiduciary duties except for certain acts, such as those involving bad faith or intentional misconduct and improper distributions (NY LLCL § 417(a).) The members' waiver of a manager's fiduciary duty may be binding if the release is given knowingly and the members are sophisticated, among other factors (*Pappas v. Tzolis*, 958 N.Y.S.2d	Partners have a fiduciary duty of loyalty (*Fischer v. KPMG Peat Marwick*, 607 N.Y.S.2d 309, 311 (1st Dep't 1994) citing *Meinhard v. Salmon*, 249 N.Y. 458 (1928)). Partners must also hold unauthorized profits in trust for the GP and are accountable as fiduciaries for unauthorized profits they receive from: • Transactions related to the GP's formation, conduct, or liquidation. • Using the GP's property. (N.Y. P'ship Law § 43.) The business judgment rule applies to partners acting as fiduciaries for the partnership and the other partners (*Levine v. Levine*, 590 N.Y.S.2d 439, 443 (1st Dep't 1992)). Partnership agreements generally can contain any matters, including limitations of liability. However, they must not violate any statutes, common law, or public policy. (*Lanier v. Bowdoin*, 24 N.E.2d 732, 735 (N.Y. 1939).)	General partners have fiduciary responsibilities to limited partners. Limited partners generally do not owe fiduciary duties. The fiduciary relationship of general and limited partners is the same as the one between corporate directors and shareholders (*Lichtyger v. Franchard Corp.*, 277 N.Y.S.2d 377, 383 (1966)). The business judgment rule shields general partners in an LP from liability absent bad faith, conflicts of interest, or personal bias (*Stuart Silver Assoc., Inc. v. Baco Dev. Corp.*, 665 N.Y.S.2d 415, 418 (1st Dep't 1997) citing *Levine*). The partnership agreement can provide for indemnification of general partners but the LP may not indemnify general partners for certain acts, such as those

A corporation's certificate of incorporation can eliminate or limit the directors' liability for subsequent breaches of their duties except for certain acts, such as those involving bad faith or intentional misconduct and improper distributions (NYBCL § 402(b).)	incorporation can eliminate or limit the directors' liability for subsequent breaches of the directors' duties except for certain acts, such as those involving bad faith or intentional misconduct and improper distributions (NYBCL § 402(b)).	656, 659 (2012)).		involving bad faith, dishonesty, or that result in personal gain to which the general partners were not legally entitled (N.Y. P'ship Law § 121-1004(b)).

Employee Incentives

C-Corporation	S-Corporation	LLC	GP	LP
Stock options can be granted to employees (can qualify as **incentive stock options** (ISOs) under the **Internal Revenue Code** (IRC) (IRC § 422)). For more information, see Practice Note, Stock Options: Overview: Incentive Stock Options. Other common forms of equity compensation include: • **Stock appreciation rights** (SARs). • **Restricted stock**. • **Restricted stock units** (RSUs). • Performance awards.	Stock options can be granted to employees (can qualify as ISOs under the IRC (IRC § 422)). For more information, see Practice Note, Stock Options: Overview: Incentive Stock Options. Other common forms of equity compensation include: • SARs. • Restricted stock. • RSUs. • Performance awards.	Profits interests or non-qualified options (to acquire a membership interest) can be granted to employees. ISOs are not available. Profits Interests provide favorable tax treatment to employees and have been more common than options (but options are becoming more common). Both profits interests and options to acquire a membership interest are less familiar than traditional stock options and may result in the employee being treated as a partner for tax and employee benefit purposes. Other equity compensation arrangements (such as RSUs) can be replicated in the LLC context but are uncommon.	Profits interests or non-qualified options (to acquire a partnership interest) can be granted to employees. ISOs are not available. Profits Interests provide favorable tax treatment to employees and have been more common than options (but options are becoming more common). Both profits interests and options to acquire a partnership interest are less familiar than traditional stock options and may result in the employee being treated as a partner for tax and employee benefit purposes. Other equity compensation arrangements (such as RSUs) can be replicated in the partnership context but are uncommon.	Profits interests or non-qualified options (to acquire a partnership interest) can be granted to employees. ISOs are not available. Profits Interests provide favorable tax treatment to employees and have been more common than options (but options are becoming more common). Both profits interests and options to acquire a partnership interest are less familiar than traditional stock options and may result in the employee being treated as a partner for tax and employee benefit purposes. Other equity compensation arrangements (such as RSUs) can be replicated in the partnership context but are uncommon.

Capital Raising Considerations

C-Corporation	**S-Corporation**	**LLC**	**GP**	**LP**
C-corporations raise capital by issuing equity (common or preferred shares) and incurring debt. Shares can be issued by **private placements** or, if the C-corporation is public, by a public offering with stock that is **registered** with the **SEC** and listed on a public securities exchange. There is a lot of flexibility in the type of shares (for example, common, preferred, convertible debt, or phantom) that can be issued but the C-corporation is limited to the number of shares authorized in its certificate of incorporation (NYBCL § 501). The number of shares authorized can be increased by filing an amendment to the certificate of incorporation, which requires shareholder approval (NYBCL §§ 801(b)(7) and 803(a)). The terms of a shareholders' agreement may restrict a C-corporation from **diluting** its current shareholders. If the corporation has issued preferred shares, warrants, or options, those holders may have	S-corporations raise capital by issuing equity (common shares) and incurring debt. Shares are typically issued in private placements. An S-corporation must be converted to a C-corporation before an IPO. It is easier for an S-corporation to convert to a C-corporation than it is for an LLC or LP to convert because an S-corporation automatically converts to a C-corporation if it does not meet the requirements of an S-corporation (IRC §1362(d)(2)).	LLCs raise capital by issuing equity (membership interests) and incurring debt. Membership interests are typically issued in private placements. Members can create membership interests that mirror the properties of different types of shares (NY LLCL § 418). LLCs are not limited to a preset number of authorized membership interests but the operating agreement may restrict an LLC from diluting its current members. Except in certain industries such as energy, LLC's are typically not publicly traded. Often the members convert the LLC to a corporation before an IPO. If an LLC is publicly traded, it generally will be treated and taxed as a corporation under the IRC unless 90% or more of the LLC's gross income consists of qualifying passive income such as dividends, interest, real property rents, natural resource income, certain commodities income, and gains from assets that produce	GPs raise capital by admitting new partners and incurring debt. Because partnership interests are not freely transferable and partners are liable for the GP's obligations, it may be hard to find new partners. However, it may be easier to obtain financing since lenders typically prefer that all owners be liable for the company's debts. GPs typically raise capital through contributions of cash, property, services, or other assets from its partners.	LPs raise capital by issuing equity (LP interests) and incurring debt. LP interests are typically issued in private placements. The partnership agreement can create partnership interests that mirror the properties of different types of shares (N.Y. P'ship Law § 121-302). LPs are not limited by a preset number of authorized interests but provisions in the partnership agreement may restrict an LP from diluting its current partners. Because limited partners cannot control the partnership without losing limited liability, it is a good vehicle when raising capital with silent investors. Except in certain industries such as energy, LPs are typically not publicly traded. Often the partners convert the LP to a corporation before an IPO. If an LP is publicly traded (called a publicly traded partnership or PTP), it generally will be treated and taxed as a corporation under the IRC unless 90% or

anti-dilution protection. The certificate of incorporation must set out the terms of the preferred shares or authorize the board to set the terms (NYBCL § 502).		passive income (IRC § 7704). If an LLC is publicly traded, membership interests (instead of shares) are bought and sold.		more of the LP's gross income consists of qualifying passive income such as dividends, interest, real property rents, natural resource income, certain commodities income, and gains from assets that produce passive income (IRC § 7704).

Distributions

C-Corporation	S-Corporation	LLC	GP	LP
Distributions to shareholders can be dividends paid in cash, in corporate bonds or property (including the shares or bonds of other corporations) or distributions in the corporation's shares (NYBCL §§ 510(a) and 511(a)). Distributions must be proportionate to share ownership within each class of shares. Preferential distributions are permitted for one class over another. (NYBCL §§ 501 and 502.) Distributions must be paid out of either surplus, so that the corporation's net assets remaining after the distribution are at least equal to the corporation's stated capital, or if there is no surplus, out of net profits for the current or preceding fiscal year (NYBCL § 510(b)). Unless acting or relying on certain information in good faith and with ordinary care, directors consenting to an unlawful distribution are jointly and severally liable (with contribution) for the amount of the unlawful	Distributions to shareholders can be dividends paid in cash, in corporate bonds or property (including the shares or bonds of other corporations) or distributions in the corporation's shares (NYBCL §§ 510(a) and 511(a)). Distributions must be proportionate to share ownership (NYBCL §§ 501 and 502). Only one class of shares is permitted (IRC §1361(b)(1)(D)). Distributions must be paid out of either surplus, so that the corporation's net assets remaining after the distribution are at least equal to the corporation's stated capital, or if there is no surplus, out of net profits for the current or preceding fiscal year (NYBCL § 510(b)). Unless acting or relying on certain information in good faith and with ordinary care, directors consenting to an unlawful distribution are jointly and severally liable (with contribution) for the amount of the unlawful distribution (NYBCL	Except as provided in the operating agreement, members are not entitled to demand and receive distributions in any form other than cash, regardless of the nature of their contribution (NY LLCL § 505(a)). Unless provided otherwise in the operating agreement, distributions are based on the value, as stated in the LLC's records, of each member's unreturned received or promised contributions (NY LLCL § 504). Distributions cannot be made if they will cause the LLC's liabilities (excluding certain liabilities to members and creditors) to exceed the fair market value of its assets, excluding the fair market value of certain property subject to creditors (NY LLCL § 508(a)). A member knowingly receiving an improper distribution is personally liable to the LLC for the amount of the distribution until, unless otherwise agreed, three years after the distribution date (NY LLCL §	Distributions are made as provided by the partnership agreement. Unless provided otherwise in the partnership agreement, partners share equally in the profits and surplus remaining after all liabilities, including those to partners, are satisfied (N.Y. P'ship Law § 40(1)).	Except as provided in the limited partnership agreement, partners are not entitled to demand and receive distributions in any form other than cash (N.Y. P'ship Law § 121-605). Distributions are allocated among the partners (and classes of partners) as provided in the LP agreement. If the LP agreement is silent, distributions are allocated based on the value of each partner's unreturned contributions. (N.Y. P'ship Law § 121-504.) Distributions cannot be made if they will cause the LP's liabilities (excluding certain liabilities to partners and creditors) to exceed the fair market value of its assets, excluding the fair market value of certain property subject to creditors (N.Y. P'ship Law § 121-607(a)). A limited partner knowingly receiving an improper distribution is liable to the LP for the amount of the distribution until, unless otherwise agreed, three years after the distribution

distribution (NYBCL §§ 719(a)(1), (e) and 717(a)).	§§ 719(a)(1), (e) and 717(a)).	508(b), (c)). Subject to statutory limitations on distributions, a member entitled to a distribution has the same status and remedies as a creditor of the LLC (NY LLCL §§ 506, 508, and 704).		date (N.Y. P'ship Law § 121-607(b), (c)). Subject to statutory limitations on distributions, a partner entitled to a distribution has the same status and remedies as a creditor of the LP (N.Y. P'ship Law §§ 121-606, 121-607, and 121-804).

Other Considerations

C-Corporation	S-Corporation	LLC	GP	LP
Regulators, financial institutions, and employees are most familiar with this form. More regulated and more record keeping requirements than LLCs or partnerships. There is a well-developed body of corporate case law and statutes that provides greater certainty but less flexibility than other entity forms.	S-corporation election is limited to eligible US entities that have a single class of shares and no more than 100 shareholders and the shareholders must be of specific types (IRC §1361(b)). More regulated and more record keeping requirements than LLCs or partnerships. There is a well-developed body of corporate case law and statutes that provides greater certainty but less flexibility than other entity forms. A New York corporation that is a federal S-corporation may elect to be a New York S-corporation if it meets New York State's requirements. The election is made on NYS Tax Dept. Form CT-6. (N.Y. Tax Law § 660(a), (b) and see NYS Tax Dept.: Instructions for Form CT-6.) Certain entities are ineligible to be New York S-corporations. For more information, see NYS Tax Dept.: S Corporations. New York City does	Regulators, financial institutions, and employees are less familiar with this form. LLCs provide the corporate benefits of limited liability with the partnership benefits of flexible management, less record-keeping requirements, and the option for pass-through taxation. Case law is less developed than corporation and partnership law. This provides more freedom but less certainty. The LLC must publish notice of its organization in two newspapers in the county in New York where its office is located for six consecutive weeks (NY LLCL § 206(a)). The cost of publication varies depending on the newspaper and can range from a few hundred dollars to almost $2,000. Newspapers in New York County are the most expensive. An LLC involved in a real estate transaction that requires the filing of a TP-584 or TP-584-	Partnerships (like LLCs) are subject to fewer formalities than corporations. GPs are discouraged as a form of business because each partner is subject to broad personal liability for the GP's obligations and the acts or omissions of other partners. Parties should organize a statutory business structure so that they do not inadvertently establish an oral partnership by operation of law (see, for example, *Griffith Energy, Inc. v. Evans*, 925 N.Y.S.2d 282, 283 (4th Dep't 2011)). Partnership common law is well-developed (similar to corporation common law) and more developed than LLC common law. Like corporation law, partnership law has a long history of interpretation in New York courts, creating relative certainty about statutory interpretation.	LPs (like LLCs) are subject to fewer operating formalities than corporations. Partnership common law is well-developed (similar to corporation common law) and more developed than LLC common law. Like corporation law, partnership law has a long history of interpretation in New York courts, creating relative certainty about statutory interpretation. The LP must publish notice of its formation in two newspapers in the county in New York where its office is located for six consecutive weeks (N.Y. P'ship Law § 121-201(c)). The cost of publication varies depending on the newspaper and can range from a few hundred dollars to almost $2,000. Newspapers in New York County are the most expensive.

	not recognize federal or New York State S-corporation status. New York and foreign S-corporations are subject to the New York City General Corporation Tax if they conduct certain activities in New York.	NYC must report the names and business addresses of its members, managers, and other authorized persons. If any are business entities, the names and business addresses of their principals and management must be disclosed until the identity of every natural person with a direct or indirect ownership interest is identified.		

2.

Shareholders Agreement Checklist (NY)

Initial Considerations

- Decide whether a long-form or short-form shareholders agreement is appropriate. A short-form agreement is usually more appropriate for a small corporation with few shareholders.
- Confirm that the shareholders will enter into one comprehensive shareholders agreement covering multiple matters. Shareholders can instead enter one or more stand-alone agreements with each addressing different specific matters (such as a **voting agreement** and a buy-sell agreement, which are types of shareholders agreements).
- Determine whether the shareholders agreement will include buy-sell provisions to address the purchase and sale of shareholders' interests if certain events occur (for example, a shareholder's death, divorce, or termination of employment with the corporation). If not, the shareholders can enter into a separate buy-sell agreement to cover these matters.
- Review the corporation's ownership structure. Minority and majority shareholders have different concerns than two shareholders with equal ownership interests. Their respective shareholders agreements should address these different concerns, such as including **deadlock** provisions when the corporation has only two 50/50 shareholders.
- Ascertain if the corporation is a **joint venture** (JV) company. Shareholders agreements for JV companies often include provisions not usually found in shareholders agreements for other corporations. For example, JV agreements typically include provisions addressing the ownership and use of **intellectual property** created by the JV company.
- Identify the corporation's investors and whether they have specific demands. For example, **private equity** firms typically want more control over management than passive investors.
- Identify any shareholders who are key employees. There are often special considerations for those shareholders reflected in the shareholders agreement (such as employment agreements and **non-compete provisions**).
- Arrange for tax advisors (such as tax counsel) to review the shareholders agreement to advise the parties about any tax implications. For example, tax advisors can advise whether the corporation should elect **S-corporation** status.
- Determine the default rule of the New York Business Corporation Law (NYBCL) if the shareholders agreement does not address a particular matter (NYBCL §§ 101 et seq.). The NYBCL applies to the corporation and its governance but certain of its provisions may be varied by the certificate of incorporation, by-laws, or the shareholders. For example, the NYBCL provides that directors are elected by a plurality but shareholders may enter into a written agreement to vote otherwise for directors (NYBCL §§ 614(a) and 620(a)).

Parties and Background

- Identify the parties to the shareholders agreement and consider whether the corporation intends to issue additional shares in the future. Even if the corporation has no plans to issue future shares, the agreement should include a form of **joinder agreement** as an exhibit and require new and transferee shareholders to sign the joinder agreement to ensure that all shareholders are entitled to the same rights and subject to the same restrictions as the original parties to the agreement.
- Determine if the corporation should be a party to the shareholders agreement. The corporation is usually a party if it has obligations to the shareholders under the agreement.

- Confirm if any shareholder is married and residing in a community property state. New York is not a community property state but the spouses of married shareholders living in community property states should be parties to the shareholders agreement or sign a spousal consent agreeing to be bound by its terms.
- If the shareholders agreement will contain recitals, determine if they should include any particular information. Recitals are not legally required and do not have any direct legal consequences but are often included to provide important or relevant background information, such as the reasons for forming the corporation.

Capital Structure

- Confirm the corporation's authorized share capital. Shareholders agreements typically set out each shareholder's shares on a schedule, and the aggregate cannot exceed the number of authorized shares fixed by the certificate of incorporation (NYBCL § 402(a)(4)).
- Identify if the corporation has multiple classes or series of shares. The shareholders agreement should reflect the different rights, preferences, and limitations among the multiple classes or series. A corporation's certificate of incorporation may permit the corporation to issue multiple:
  - classes of shares, including common shares and **preferred shares** (NYBCL § 501(a), (b)); and
  - series of preferred shares (NYBCL § 502(a)).
- Determine if the corporation has granted or intends to grant contingent rights, such as **options**, **warrants**, or convertible shares. The shareholders agreement should account for these rights. A corporation may:
  - create and issue rights or options entitling the holders to buy shares of any class or series from the corporation, unless limited by the NYBCL or its certificate of incorporation (NYBCL § 505(a)(1)); and
  - issue shares convertible into or exchangeable for shares of any class or series, cash, other property, indebtedness, or other securities of the same or another corporation, unless the certificate of incorporation provides otherwise and subject to NYBCL §§ 513 and 519(c), (d) (NYBCL § 519(a)).
- Decide whether the shareholders agreement will require shareholders to **contribute** additional capital to the corporation.

Governance

- Confirm whether a board of directors or other persons serve as the corporation's governing authority. Although a board typically manages the corporation, the certificate of incorporation may provide for the corporation's business to be managed by one or more shareholders or other persons or corporations selected by one or more shareholders (NYBCL §§ 620(b) and 701). Omitting a board of directors entirely can create pragmatic problems, such as the inability to provide board resolutions required by lenders.
- If the corporation's governing authority is a board of directors, determine if the shareholders have agreed who will serve as the directors. Shareholders agreements often establish the individuals who will serve as the corporation's initial directors.
- Determine how board members can be removed and board vacancies filled. The shareholders agreement provisions regarding removal and vacancies must not conflict with the NYBCL, certificate of incorporation, or by-laws (NYBCL §§ 705 and 706). However, shareholders can agree on how to vote for the removal of directors or to fill vacancies in the shareholders agreement, such

as agreeing not to vote to remove directors nominated by other shareholders, or on what constitutes "cause" for the removal of a director.

- Identify any particular shareholders or holders of certain classes of shares that have the right to designate board members. For example, each class of preferred shares typically has the right to elect a director to represent its interests. To ensure a shareholder's or class of shareholders' nominee is elected to the board, include a provision in the agreement contractually obligating the other shareholders to vote their shares to elect that nominee. Voting agreements must be in writing to be valid (NYBCL § 620(a)).
- Determine if the shareholders agreement should address officer-related matters. The board elects the corporation's officers (unless the certificate of incorporation grants the right to shareholders) and the by-laws usually address their powers and duties (NYBCL § 715). However, a shareholders agreement might set out the names of the initial officers or the terms or conditions of their employment, such as defining "cause" for removal. Ensure that any officer-related provisions in the shareholders agreement do not conflict with any provisions in employment agreements.
- Confirm if the directors have the right to create board committees and if the shareholders agreement should address these committees. To the extent authorized by the certificate of incorporation, by-laws, or board resolution establishing the committee, committees may exercise the authority of the board within the limits prescribed by the NYBCL (NYBCL § 712(a)).
- Decide if the shareholders agreement will grant particular shareholders or holders of certain classes of shares the right to designate **board observers**.
- Identify any restrictions on the board of directors' authority. For example, the shareholders agreement can require shareholder consent for the board to take certain actions.
- Determine if any board actions require approval of specified board members. For example, certain matters may require the consent of the board member representing a particular class of shareholders.

Shareholder Approval

- Consider the matters requiring shareholder approval. The NYBCL sets out the voting requirements to approve certain actions, including the required voting threshold and the parties that must vote to approve the action (whether the board, the shareholders, or both), but the shareholders agreement may expand the matters requiring shareholder consent.
- Consider the level of consent required for shareholder approval. Determine if approval requires:
  - the vote of shareholders holding a **supermajority**, majority, or other percentage of the corporation's outstanding shares; or
  - unanimous shareholder consent.
- Ensure the voting requirements in the shareholders agreement are consistent with the corporation's governing documents and the NYBCL. For example, the shareholders agreement cannot:
  - require a lesser shareholder vote or quorum than the certificate of incorporation requires for an action, which may be greater than the NYBCL requirement (NYBCL §§ 614 and 616(a)); and
  - allow shareholders to act by less than unanimous written consent unless the corporation's certificate of incorporation permits it (NYBCL § 615(a)).
- Confirm if there are any other shareholder voting requirements in the governing documents or that should be included in the shareholders agreement, such as whether:
  - certain shareholders or classes of shares have special voting rights; and
  - the shareholders vote together or on a class-by-class basis. For example, if there is an outstanding class of preferred shares, the preferred class often votes on matters separate and apart from the common shareholders.

Restrictive Provisions

- Consider if there is a need for confidentiality provisions for certain corporate information. Most businesses have valuable confidential information, such as **trade secrets**, they want to protect from disclosure.
- Identify if there is a need for non-compete provisions and if they should apply to all shareholders or only those who are key employees. Shareholders in management positions are often restricted from competing with the corporation but minority investors not involved in the corporation's operations may not be.
- Decide if the agreement should include any other restrictive provisions or agreements. For example, shareholders agreements sometimes require shareholders to submit corporate opportunities to the corporation and establish the terms and conditions regarding the corporate opportunity.

Information and Inspection Rights

- Determine if the shareholders want the right to receive any documents beyond those the NYBCL and common law require the corporation to deliver. New York corporations must give shareholders certain records and information.
- Confirm the type of **financial statements** the corporation can produce and how much time it needs to prepare and deliver them.
- Identify which shareholders are entitled to receive these documents. Other than information the shareholders are entitled to receive under the NYBCL and common law, shareholders agreements may limit the shareholders who can receive certain corporate documents to those owning more than a specified percentage of the corporation's shares.

Distributions

- Confirm if certain shareholders or classes of shares have priority over others regarding the corporation's **distributions** and if this is reflected in the shareholders agreement.
- Determine if the corporation's certificate of incorporation contains a distribution policy and, if so, consider including it in the shareholders agreement.
- Ensure that all distribution requirements and policies are consistent with the NYBCL.

Share Transfers

- Determine the appropriate restrictions on share transfers.
- Confirm whether the shareholders agreement will allow shareholders to encumber their interests, such as **pledging** their shares as **collateral** for a loan.
- Identify the parties that must approve a share transfer in the shareholders agreement, such as:
    - the board of directors; or
    - the shareholders holding a certain percentage of the corporation's outstanding shares or percentage of shares entitled to vote or vote for directors.
- Determine if the shareholders agreement will permit any transferees to receive shares without prior approval from the board or shareholders. Shareholders agreements usually permit shareholders to transfer their interests to a defined group of permitted transferees without prior approval or other transfer restrictions. Permitted transferees may include:

- other shareholders;
- certain family members and trusts for estate planning purposes; and
- **affiliates**.

- Decide if the shareholders agreement should include other exceptions to share transfer restrictions, such as entitling shareholders to:
  - a **right of first refusal** (ROFR); or
  - a **right of first offer** (ROFO).
- Consider if the shareholders should be entitled under the shareholders agreement to **drag-along rights**, **tag-along rights**, or both and, if so, the circumstances that trigger them. Parties often include these provisions when there is one shareholder that owns a substantial majority of the corporation's outstanding shares.
- Confirm if the agreement should contain provisions for resolving **deadlock**. Corporations typically use these provisions when there is a 50/50 ownership structure. Examples of deadlock resolving methods include:
  - provisions requiring **mediation** or **arbitration**;
  - buy-sell provisions; and
  - provisions requiring a third party to decide the dispute outside of the legal process.
- If the parties are including buy-sell provisions in the shareholders agreement, such as **put rights** and **call rights**, identify the triggering circumstances.
- For any buy-sell provisions, determine how to value the transferred shares.
- Determine the procedures to add transferees as parties to the shareholders agreement. The agreement usually requires transferees to sign:
  - a joinder agreement agreeing to be a party to and bound by the shareholders agreement; and
  - if applicable, a spousal consent.
- Ensure that all share certificates and statutory notices for uncertificated shares conspicuously note share transfer restrictions (NY UCC § 8-204).

Preemptive Rights

- Determine if the shareholders are entitled to **preemptive rights** under the corporation's certificate of incorporation (NYBCL § 622). Shareholders agreements typically address the terms of any preemptive rights.
- If the shareholders have preemptive rights, decide if the shareholders may purchase more than their **pro rata** share of future share issuances.
- Consider whether the preemptive rights apply only to new share issuances or include options, warrants, and other types of **securities**.
- Identify any limitations imposed on the preemptive rights. Certain share issuances are often excluded from preemptive rights, such as shares issued in connection with a **merger** or acquisition or as part of an employee bonus or compensation plan.

Representations and Warranties

- Decide if the shareholders are making any **representations and warranties**. Shareholders agreements often include representations and warranties covering matters such as:
  - the shareholder's individual legal capacity or entity power and authority to enter into the agreement;
  - the agreement's enforceability against the shareholder; and

  - the non-existence of conflicting agreements.
- If it is a party, consider if the corporation should make any representations and warranties to the shareholders.

Termination

- Confirm the events causing the shareholders agreement to terminate. Shareholders agreements typically terminate by agreement of the shareholders or if an event occurs that causes the termination of the corporation's operations, such as **insolvency**, bankruptcy, or **winding up**.
- Determine if the shareholders agreement should limit its own term or duration.
- Identify any provisions of the shareholders agreement that survive termination. For example, confidentiality provisions usually survive termination.

Miscellaneous

- Confirm that New York law should govern the shareholders agreement. It is common to choose the laws of the corporation's state of incorporation.
- Determine the appropriate **venue** and jurisdiction if there is a dispute over the shareholders agreement. Shareholders agreements for New York corporations usually require parties to submit to the jurisdiction of New York courts.
- Decide if the agreement should include **alternate dispute mechanisms**, such as arbitration or mediation.
- Determine the consent required to amend the shareholders agreement.
- Consider if any third parties should have rights under the shareholders agreement.

Schedules and Exhibits

- Collect all information necessary to complete any schedules or exhibits to the shareholders agreement. Schedules often contain information that is too lengthy to include in the body of the agreement or that is easier to view in a table format on a separate page. Exhibits usually include forms referenced in the body of the agreement, such as a form of joinder agreement and spousal consent.

Authority and Conflicts

- Ensure that the provisions of the shareholders agreement, including any shareholder approval requirements, do not conflict with the NYBCL or the corporation's governing documents. If there is a conflict, the NYBCL prevails (unless the NYBCL expressly provides otherwise), followed by the corporation's certificate of incorporation and then the corporation's by-laws (NYBCL §§ 402(c) and 601(b)).
- If the shareholders want terms in the shareholders agreement that are inconsistent with the corporation's certificate of incorporation or by-laws, amend these governing documents by following the amendment and approval process set out in the respective documents and the NYBCL.
- Determine if any other shareholders agreements exist. If there is an existing agreement (such as a buy-sell agreement), ensure the shareholders agreement does not conflict with it. Before amending an existing agreement, review and comply with the existing agreement's approval and amendment provisions.

3.
Operating Agreement Checklist (NY)

Initial Considerations

- Is this a single-**member** or multi-member **limited liability company** (LLC)? A New York LLC must have at least one member when formed (NY LLCL § 203(c)). Under the New York Limited Liability Company Law (NY LLCL) (NY LLCL §§ 101 et seq.), a member is any individual, corporation, LLC, trust, or other entity that has been admitted to and has a membership interest in the LLC (NY LLCL § 102(q), (w)). The LLC's organizer does not have to be a member of the LLC (NY LLCL § 203(b)).
- Will the LLC use a long or short form **operating agreement** (also known as an LLC agreement)? The LLC's members must adopt a written operating agreement (NY LLCL §§ 417(a)).
- Are there majority and minority **membership interests** or are the interests divided evenly among the members? Minority and majority parties often have different concerns than members in an LLC with evenly divided interests.
- Is this a **joint venture** company? Operating agreements for joint venture companies often include provisions not usually found in operating agreements for other companies (such as provisions regarding the ownership and use of intellectual property created by the LLC).
- Who are the LLC's investors? For example, **private equity** firms typically want more control over management than passive investors.
- Are any of the members key employees? If so, there are often special considerations for those members (such as employment agreements and **non-compete provisions**).
- Are tax advisors reviewing the operating agreement? Tax advisors (such as tax counsel) should review the operating agreement, especially the tax matters section and the allocations and distributions provisions, to ensure that matters such as the timing and computation of members' distributions are stated properly.
- If there is no provision in the operating agreement governing a particular matter, what is the NY LLCL default rule, if any? This Checklist identifies default provisions that may be particularly relevant when preparing an operating agreement.

Parties and Background

- Are all of the parties identified in the operating agreement? The operating agreement does not have to be adopted by all the members. A majority in interest of the members entitled to vote can adopt the operating agreement, unless the operating agreement provides otherwise (NY LLCL § 402(c)(3)). A majority in interest of the members means the members that in the aggregate are entitled to more than half of all the members' shares of the LLC's current profits, unless the operating agreement provides otherwise (NY LLCL § 102(o)).
- Will the LLC be a party to the operating agreement? The LLC is usually a party if it has obligations to the members under the agreement.
- Is the operating agreement effective when signed or on a different date? An operating agreement may be entered into before, at the time of, or within 90 days after the filing of the articles of organization. Regardless of when the agreement is entered into, it cannot be effective before the LLC's formation. (NY LLCL § 417(c).)
- Is there any important or relevant background information to include in the recitals? For example, the recitals may state the reasons for forming the LLC.

Organizational Matters

- What is the LLC's name?
- Does the LLC's name meet the following NY LLCL's requirements:
  - contain "Limited Liability Company" or the abbreviation "L.L.C." or "LLC" (NY LLCL § 204(a));
  - refrain from using any restricted or prohibited word or phrase (NY LLCL § 204(d)-(i));
  - distinguishable from the names of other business entities (NY LLCL § 204(b)); and
  - used by the LLC to transact business, unless it will use an assumed name (NY LLCL § 204(c), N.Y. Gen. Bus. Law § 130(1)(b))?
- Have the members provided their contact information (mailing address, telephone and fax numbers, email address, and principal contact)? The LLC must maintain records regarding the members' names and mailing addresses (NY LLCL § 1102(a)(2)). This information is often attached as a schedule to the operating agreement.
- When will the LLC be formed? The operating agreement cannot be effective before the LLC is formed (NY LLCL § 417(c)). A New York LLC is formed when the initial articles of organization are filed with the New York State Department of State (DOS), unless the articles specify a later date (not more than 60 days after filing) (NY LLCL § 203(d)).
- Has the LLC designated the New York Secretary of State (SOS) as its agent for service of process in its articles of organization, as required by the NY LLCL? Do the articles of organization also include the post office address in the US where the SOS can mail a copy of any process served on the SOS? (NY LLCL § 203(e)(4).)
- Will the LLC also designate a **registered agent** for service? If so, the article of organization must include the name and New York address of the registered agent and a statement that the registered agent is the LLC's agent upon whom process against the LLC may be served. (NY LLCL § 203(e)(5).)
- Where is the LLC's principal place of business? Will it operate branch offices or locations?
- Will the LLC conduct business in other states besides New York? If so, does the LLC need to file for **foreign qualification** in those other states?
- How long will the LLC exist? Is there a known or anticipated date or event that will cause the LLC to end? The LLC may exist in perpetuity but, if it has a date certain for dissolution, it must include that date in its articles of organization. In addition to the dissolution events specified in the NY LLCL, the articles of organization or operating agreement may describe dissolution events. (NY LLCL §§ 203(e)(3), (7) and 701(a)(1), (2).)
- What is the LLC's general purpose? Will it be narrow in scope (for example, to buy a piece of real estate or perform obligations under a government contract) or broad (for example, to conduct any business allowed by law)? An LLC can have any lawful business purpose except those that must be conducted by an individual or another entity form (NY LLCL § 201). In petitions for judicial dissolution under Section 702 of the NY LLCL, one factor courts consider is whether the purpose stated in the operating agreement is being achieved (*In re 1545 Ocean Ave., LLC*, 893 N.Y.S.2d 590, 598 (2d Dep't 2010)). Judicial dissolution may be more difficult to obtain if the LLC has a broad purpose.
- Will the articles of organization restrict any of the powers otherwise granted by the NY LLCL (NY LLCL § 202)?
- If the LLC is forming under a merger or conversion, are the properties of the old business being transferred to the LLC? Can or should the old business's licenses, insurance, or other authorizations

be transferred to the LLC? Has the certificate of merger or conversion been filed? Will the LLC accept or assume the liabilities of the old business? (NY LLCL §§ 1004 and 1007.)

- Will the LLC be a professional service LLC (PLLC) providing a professional service that requires the individuals providing the service or the members to be licensed by New York? If so, do those individuals and the members have the proper licenses? PLLCs are subject to licensing requirements and transfer restrictions that do not apply to other LLCs (NY LLCL §§ 1203, 1204(a), 1207, and 1209 to 1211). These requirements and restrictions should be reflected in the operating agreement.
- Does the LLC require a license to operate its business? Depending on its type of business and where it is located, the LLC may need to obtain local and state business licenses.
- Has the county clerk provided the names of two newspapers (one published weekly and the other daily) in the county of the LLC's office that will publish notice of the LLC's formation (NY LLCL § 206)? Has the cost of publication been taken into consideration?

Member Considerations

- How can new members be admitted? Unless the operating agreement or articles of organization provide otherwise, the admission of new members requires a vote of a majority in interest of the members entitled to vote (NY LLCL §§ 402(c)(1) and 203(e)(7)).
- If the LLC is manager-managed, does the admission of new members require the consent of the manager? Will the operating agreement allow the manager to unilaterally update the operating agreement to reflect new members?
- What are the limitations of liability and indemnification provisions (NY LLCL §§ 417(a) and 420)? Operating agreements usually provide that:
    - members are not liable for more than their capital contribution; and
    - subject to certain exceptions, the LLC will indemnify members from and against claims and demands resulting from being a member or manager of the LLC.
- Can members enter into transactions with the LLC? For example, can the members make loans to the LLC? Members can transact business with the LLC, including lending or borrowing money or acting as guarantor, unless the operating agreement provides otherwise (NY LLCL § 611).
- Has each member provided any other information required for disclosures and compliance with applicable law (such as for federal tax purposes or for the **Office of Foreign Assets Control** (OFAC))?

Voting and Action

- Will the members have voting rights in addition to the voting rights granted under the NY LLCL? If so, consider:
    - what other matters can they vote on? The NY LLCL grants members, regardless of whether the LLC is member-managed or manager-managed, the right to vote on significant matters (such as the sale of all or substantially all of the LLC's assets), unless the operating agreement provides otherwise (NY LLCL § 402(c), (d)). Operating agreements usually grant members the right to vote on the same matters as authorized under the NY LLCL but also list additional matters that require member consent (such as initiating an initial public offering).
    - what vote is required to approve each matter (majority, supermajority, or unanimous)? Does the required level of consent comply with the NY LLCL?
    - are there any actions that require a lesser or higher threshold vote than others? For example, the LLC may specify that certain matters require majority consent while others require

supermajority or unanimous consent (such as dissolving the LLC). Any provision of the NY LLCL, articles of organization, or operating agreement that requires a minimum percentage in interest of the members to approve an action can only be amended by at least that minimum percentage (NY LLCL § 402(e)).
  - will the votes of members be calculated based on their percentage of membership interests, share of the LLC's current profits, or some other basis? The NY LLCL's default rules calculate the members' vote based on their share of the LLC's current profits but the operating agreement may amend this (NY LLCL §§ 102(o) and 402(a)).
- Will the operating agreement vary the members' default minimum approval requirements under the NY LLCL and, if so, what will those thresholds be (NY LLCL § 402(c), (d), (f))?
- Can members act without having a meeting? If so, is unanimous consent required? Unless the operating agreement provides otherwise, members may act by less than unanimous written consent (NY LLCL § 407(a)).
- Can the members act by **proxy**? Members may vote in person or by proxy unless the operating agreement provides otherwise (NY LLCL § 402(b)).
- Will the operating agreement address meetings and actions by the members? Unless the operating agreement provides otherwise, members must have an annual meeting (NY LLCL § 403). Consider whether to include provisions relating to:
  - annual and special meetings;
  - notice of meetings;
  - setting a **record date**;
  - **quorum** requirements;
  - acting by written consent;
  - acting by proxy; and
  - majority, unanimous, or other minimum voting thresholds needed to act.
- Will the operating agreement include deadlock provisions? If so, the following are common ways to deal with deadlocks:
  - **mediation** or **arbitration**;
  - buy-sell provisions; and
  - third-party referee outside of legal process.

Withdrawal or Termination of a Member

- How can a member withdraw from the LLC? Can a member withdraw before the dissolution and winding up of the LLC? Under the NY LLCL, a member may withdraw only as specified in the operating agreement. Additional restrictions apply under the NY LLCL but vary depending on whether the LLC was formed before, on, or after August 31, 1999. (NY LLCL § 606.)
- If a member can withdraw, what notice or process must the member follow to withdraw? If withdrawal is permitted by the operating agreement, it should include provisions that address the process and consequences of withdrawal.
- What liability, if any, will there be for wrongful withdrawal?
- If a member withdraws, what distribution (if any) will the withdrawing member be entitled to? Assuming withdrawal is permitted, a withdrawing member is entitled to receive:
  - any distribution due to that member under the operating agreement; and
  - the fair value of that member's membership interest in the LLC as of the withdrawal date, unless the operating agreement provides otherwise.
- (NY LLCL § 509.)

- How will the LLC handle the retirement of a member? Will the remaining members have the right to buy out the retiring member? Will there be a mandatory retirement age at which a member must cash out? Will there be a reduction in the amount of the buy-out depending on how early the member retires?
- What happens if a member becomes disabled? If the disability is temporary, will the member receive full or partial salary or other compensation? If the member is permanently disabled or the disability continues for a specified time, do the LLC or the other members buy the disabled member's interest? Will the buy-out be mandatory? Will the LLC buy insurance to cover these types of contingencies?
- Can a member be expelled? There is no statutory provision in the NY LLCL providing for expulsion. The right to expel a member must be authorized in the operating agreement.
- If the operating agreement allows for the expulsion of a member, what process must be followed to expel the member? When will the expulsion become effective?
- Will the LLC buy the expelled member's interest (**redemption**) or will members be required to purchase the expelled member's interests (cross-purchase)? If so:
    - how will the parties determine the purchase price?
    - what will be the terms of payment (for example, timing of payments and interest and security for payment of the purchase price)?
- The LLC should consult an accountant or tax professional to take advantage of any tax benefits associated with a buyout provision.
- Are the provisions in the operating agreement that address withdrawal and termination consistent with any buy-sell provisions or transfer restrictions in the operating agreement or standalone buy-sell agreement?

Membership Interests

Do the articles of organization provide for more than one class of membership interests (NY LLCL § 418(a))?

- If so, consider the following for each class:
    - voting rights;
    - common or preferred membership interests;
    - **allocation**, **distribution**, and **liquidation preferences** (priorities among classes of membership interests are usually contained in provisions of the operating agreement known as **waterfall provisions**);
    - management rights;
    - additional **capital contributions**; and
    - **pre-emptive rights** to avoid **dilution**.
- Will the membership interests need to be registered under New York's **blue sky laws**, known as the Martin Act (N.Y. Gen. Bus. Law §§ 352 to 359-h)? Will the LLC need to file appropriate documents for an exemption from registration under the **Securities Act of 1933** (Securities Act), such as **Form D**?
- Will the LLC issue **profits interests** to members or employees?
- Will the membership interests be evidenced by certificates? Membership interests may be certificated or uncertificated (NY LLCL § 603(b)).

Transfers of Interests

- Can membership interests be assigned? Unless the operating agreement states otherwise, membership interests are assignable (NY LLCL § 603(a)(1)). Operating agreements typically allow assignments subject to certain transfer restrictions.
- Does an assignment entitle the assignee to become a member or have any voting rights? Unless the operating agreement provides otherwise:
  - an assignee is not a member unless at least a majority in interest of the non-assigning members agree (NY LLCL § 604(a)); and
  - an assignee receives the economic interests but not voting, management, or other member rights associated with the membership interest (NY LLCL § 603(a)(2), (3)).
- What transfer restrictions will the operating agreement impose? Operating agreements often contain detailed transfer restrictions. If the LLC is treated as a partnership for US federal income tax purposes, any transfer (or withdrawal) that causes the LLC to be treated as a corporation for US federal income tax purposes is generally prohibited despite any other provisions of the operating agreement.
- Whose consent will be required to approve an assignment (for example, the manager or the members)?
- Who are the permitted assignees (for example, family trusts, **affiliates**, immediate family members, or other members)? Operating agreements typically allow transfers of membership interests to a defined group of assignees without prior consent even though the assignees have no right to be part of the management of the LLC's affairs.
- What are the procedures for admitting assignees as additional members? New members (including assignees of existing membership interests) usually have to meet certain requirements before becoming a member for purposes of the operating agreement (such as agreeing to be bound by the operating agreement and certifying that the member is an **accredited investor** under the Securities Act).
- If an assignee is not admitted as a member under the operating agreement, what will that assignee be entitled to? Unless the operating agreement provides otherwise, an assignee not admitted as a member is typically only permitted to receive the economic benefit of the assigned membership interest (NY LLCL § 603(a)(3)).
- Will the operating agreement restrict the members from encumbering their membership interests, such as using them as collateral for a personal business loan? The NY LLCL allows a member to pledge or grant security interests in a membership interest without affecting the member's rights unless the operating agreement provides otherwise (NY LLCL § 603(a)(4)).
- What types of transfer and buy-sell provisions will the operating agreement include? Common examples include:
  - **tag-along** and **drag-along rights**;
  - **rights of first offer**;
  - **rights of first refusal**;
  - **put option**; and
  - **call option**.
- Will the LLC include buy-sell provisions in the operating agreement or in a separate buy-sell agreement? These provisions are often included in the operating agreement.
- If there are buy-sell provisions, do they address valuation and payment methods?
- Are the buy-sell provisions and transfer restrictions, if any, consistent with any provisions in the operating agreement addressing withdrawal or termination of members?

Management

- What is the management structure? Will the LLC be member-managed or will the members delegate that responsibility to one or more managers or even an executive committee, board of directors, or officers? Unless the articles of organization provide otherwise, the members manage the LLC (NY LLCL § 401(a)). If the LLC will be managed by members, the considerations addressed below regarding managers apply to the managing members.

Member-Managed

- If the LLC is member-managed, will it be managed by all of the members or only certain members or classes of members? Unless the articles of organization or operating agreement provide otherwise:
  - the LLC is managed by all the members; and
  - any member exercising management powers or responsibilities is deemed a manager of the LLC unless the context requires otherwise.
- (NY LLCL §§ 401 and 408(a).)
- What are the members' powers? Every member of a member-managed LLC is an agent of the LLC and can bind the LLC, unless the member had no authority to act and the third party knew the member lacked authority (NY LLCL § 412(a)).
- Will any member be compensated for services provided to the LLC?
- Can members appoint officers and delegate authority?

Manager-Managed

- If the LLC is manager-managed, will it be managed by one manager or by a separate board of managers? In a manager-managed LLC, a manager is any person or entity the members name to manage the LLC as provided in the operating agreement (NY LLCL § 102(p)).
- Will the operating agreement specify qualifications for managers (NY LLCL § 410(b))? Unless the operating agreement provides otherwise, a manager:
  - is not required to be a member (NY LLCL § 410(a)); and
  - may be an individual, corporation, LLC, association, trust, or other "person" as defined under the NY LLCL (NY LLCL § 102(p), (w)).
- Who will be the initial managers? Operating agreements often identify the initial managers and provide for the process to elect managers. Will members elect managers periodically or will the agreement provide for managers to act indefinitely or for a term? Unless the operating agreement provides otherwise, members of a manager-managed LLC must elect the managers annually (NY LLCL § 413(a)).
- If there is an even number of managers, how will they settle any deadlocks between or among them?
- How can a manager be removed? Unless the operating agreement provides otherwise, a majority in interest of the members entitled to vote on removal can vote to remove managers with or without cause (NY LLCL § 414).
- How can manager vacancies be filled (for example, if a manager resigns or is removed)? Unless the operating agreement provides otherwise, vacancies may be filled by the vote of members with a majority in interest (NY LLCL § 416(a)).
- What are the managers' powers? Do certain managers have blocking rights over certain LLC

actions? Every manager of a manager-managed LLC is an agent of the LLC and can bind the LLC, unless the manager has no authority to act in the matter and the third party knew of this lack of authority (NY LLCL § 412(b)(2)).
- Will there be any limitations on the managers' powers? What management authority or responsibility, if any, will be retained by the members?
- Will the managers be compensated for acting as managers?

Liability and Indemnification

- Regardless of the LLC's management structure, what standards of conduct will the members or managers be held to? Unless the operating agreement provides otherwise, a manager must perform the manager's duties in good faith and with the same degree of care that an ordinarily prudent person in a similar position and circumstance would use (NY LLCL § 409(a)). Members in a member-managed LLC are subject to the same standards (NY LLCL § 401(b)(ii) and see *Marcus v. Antell*, 2018 WL 4849375, *4-5 (Sup. Ct. N.Y. Co. October 5, 2018) (stating that, if management is vested in all members of a member-managed LLC, each member owes fiduciary duties regardless of how active the member is in the LLC's management)).
- Will the operating agreement include provisions limiting or eliminating the managers' personal liability for a breach of duty? These provisions are subject to restrictions set out in the NY LLCL (NY LLCL § 417(a)).
- Will the operating agreement include specific indemnification procedures for the managers? Operating agreements typically indemnify managers to the maximum extent allowed by law. They may also include restrictions or standards for indemnification (NY LLCL § 420).

Officers and Directors

- Will the LLC have officers? The NY LLCL does not require officers.
- If the LLC has officers, who will have the authority to appoint officers and how will they be appointed? Options for appointing officers include, but are not limited to, approval by:
    - a majority of the members;
    - a majority of the managers; or
    - the sole member of a single-member LLC.
- What are the powers and responsibilities of the officers?
- How can officers be removed?
- Will the LLC have a board of directors? The parties cannot assume that the statutory law or common law regarding corporate directors applies to LLC directors. Therefore, the operating agreement must clarify the board's:
    - role in governing the LLC;
    - relationship to the managers and members;
    - responsibilities;
    - procedures for choosing and removing officers; and
    - authority to act.

Economic Considerations

Capital Contributions

- What will be the form and amount of the members' initial capital contributions? Contributions can consist of one or more of the following:
  - cash;
  - property;
  - services rendered; or
  - a promissory note or other obligation to contribute cash or property or to render services.
- (NY LLCL § 501.)
- When are the initial capital contributions due? Members can make the capital contributions at or before formation, according to a schedule, or on the occurrence of certain events.
- Are additional contributions allowed? If so, what is the procedure for additional contributions?
- Will additional capital contributions (**capital calls**) ever be required? If so, consider:
  - who determines when to call an additional capital contribution. In a manager-managed LLC, this is often in the management's discretion;
  - how members are notified of capital calls;
  - how much each member will be responsible to contribute; and
  - how the LLC can raise any additional funds not provided by the members.
- What are the liabilities and responsibilities of the members if one member does not make a required capital contribution?
- Will there be penalties or consequences for a member who fails to make a required capital contribution? The operating agreement may provide for penalties and consequences including:
  - reducing or eliminating the defaulting member's interest;
  - subordinating the defaulting member's interest to the non-defaulting members' interests;
  - forcing the sale of the defaulting member's interest; or
  - borrowing funds from the other members to cover the defaulting member's commitment.
- (NY LLCL § 502(c).)
- Are members entitled to interest on their capital contributions? They usually are not.

Capital Accounts

- Will the operating agreement provide for the establishment and maintenance of **capital accounts**?
- Will the operating agreement state that members are not obligated to restore a negative capital account balance? Such an obligation would undermine the separation between an LLC and its members and effectively impose potentially unlimited liability on the members.
- Will the capital account of a transferring member transfer to a transferee on the transfer of part or all of a membership interest?
- Will withdrawals of amounts from a member's capital account be permissible or required?
- Did tax counsel or any other tax advisor review the section regarding capital accounts in the operating agreement to ensure compliance with applicable New York and federal tax law?

Allocations and Distributions

- Do certain members or classes of membership interests have priority regarding distributions or allocations?

- How will profits and losses be allocated? Net profits and net losses may be allocated simply according to the agreed value of each member's percentage ownership of the LLC or according to a more complicated waterfall provision. If the operating agreement does not specify how profits and losses are allocated, they will be allocated based on the value (as stated in the LLC's records) of each member's contributions, excluding defaulted contribution obligations and any contributions that have been returned to that member (NY LLCL § 503).
- If the LLC is manager-managed, will distributions of company funds be at the manager's discretion or made at established times? If the latter, how will those times be established? For example, will the operating agreement require distributions at specified dates or intervals or on the occurrence of specified events?
- How will distributions be made? Similar to allocations of profits and losses, distributions are often made according to percentage ownership or a waterfall provision. If the operating agreement does not specify how to make distributions, they are made based on the value (as stated in the LLC's records) of each member's contributions, excluding defaulted contribution obligations and any contributions that have been returned to that member (NY LLCL § 504).
- Besides cash, will the distribution of securities and other LLC property be permitted? Unless the operating agreement provides otherwise, a member can refuse to accept a distribution of an asset in kind to the extent that the percentage of the asset distributed to that member exceeds the percentage in which the member shares in the LLC's distributions (NY LLCL § 505(b)).
- Is there a provision providing for tax distributions to cover members' tax obligations attributable to their membership in the LLC?
- Are there restrictions on distributions? Under the NY LLCL, an LLC cannot distribute funds if it would cause the LLC's liabilities to exceed the fair market value of its assets (NY LLCL § 508(a)).
- If the operating agreement permits a member to withdraw, is the member entitled to a full distribution or payment of the value of the member's interest on withdrawal?
- Did tax counsel or another tax advisor review the section regarding allocations and distributions in the operating agreement to ensure that it will not have unintended consequences for the LLC or its members?

Taxes, Books, and Records

Taxes

- How will the LLC be treated for US federal income tax purposes? Many LLCs are treated as pass-through entities, which means they are not subject to US federal income tax. Unless the LLC specifically elects to be treated as a corporation, it can avoid the entity-level tax imposed on C-corporations. Typically:
  - a single-member LLC is treated as a sole proprietorship, branch, or division of the owner; and
  - a multi-member LLC is treated as a partnership.
- How will the LLC be treated for New York state income tax purposes? A New York LLC will be treated for New York state tax purposes the same as it is treated for federal income tax purposes. The LLC will need to file certain tax forms with New York state depending on the LLC's tax classification.
- Is the LLC going to operate in New York City? If so, depending on the LLC's tax classification, it may be subject to the New York City General Corporation Tax, Business Corporation Tax, or Unincorporated Business Tax. The LLC may also be subject to other city and local taxes. The parties should consult with local tax specialists.

- Must the LLC prepare and distribute monthly, quarterly, or annual financial statements or reports? If so, do any or all of them have to be prepared in accordance with **generally accepted accounting principles** (GAAP)?
- Will the operating agreement include provisions for preparing and filing the LLC's tax returns?
- What is the LLC's fiscal year?
- Who is the partnership representative (and designated individual, if applicable) (IRC § 6223)? The operating agreement generally specifies the tax matters member's duties and any supplemental powers, such as:
  - making any tax elections on behalf of the LLC;
  - filing tax returns; and
  - representing the LLC in foreign, state, and local audits and judicial tax proceedings.
- What powers do the members have over actions of the partnership representative (and designated individual, if applicable)? The partnership representative has sole authority to represent the LLC in US federal income tax audits under revised partnership audit rules, and the LLC agreement may restrict this authority by:
  - requiring the partnership representative to notify the members of the beginning of any tax audit, receipt of a tax assessment, or receipt of a final partnership adjustment;
  - preventing the partnership representative from entering into a settlement agreement, or taking other actions (for example, extending the statute of limitations) without the consent of a specified percentage of the members; and
  - requiring the partnership representative to take certain actions to reduce an imputed underpayment (the tax assessed against the LLC) or, alternatively, to either opt out of the revised partnership audit rules if this option is available, or to elect procedures to push out adjustments to audited-year members.
- Is there a provision addressing tax withholding?
- Does the LLC need an **employer identification number** (EIN)? If the LLC has more than one member, it must obtain its own EIN regardless of whether it has employees. A single-member LLC also must have an EIN if it elects to be taxed as a corporation rather than a sole proprietorship. An EIN is also required for:
  - opening a bank account for the LLC;
  - federal and state tax reporting purposes (for example, an LLC with a single owner and treated as a disregarded entity or sole proprietorship must obtain an EIN to report excise taxes); and
  - hiring employees (for example, an LLC with a single owner and treated as a disregarded entity or sole proprietorship must obtain an EIN to report and pay employment taxes).

Books and Records

- Will the LLC prepare and distribute monthly, quarterly, or annual financial statements or reports? If so, do any or all of them have to be prepared in accordance with GAAP, IFRS, or other accounting conventions?
- What are the policies for preparing and maintaining the LLC's books and records? Have the NY LLCL's requirements for the keeping of certain records been addressed (NY LLCL § 1102(a))?
- What provisions will the operating agreement include for members and managers to inspect the books and records of the LLC? Under the NY LLCL, any member may inspect and copy, at the member's own expense, for a purpose reasonably related to the member's interest in the LLC:
  - the records listed in Section 1102(a) of the NY LLCL;
  - the LLC's financial statements for the last three years; and

    - any other information concerning the LLC's affairs as is just and reasonable.
- (NY LLCL § 1102(b).)
- Members may also seek an equitable accounting under common law, which encompasses more detailed financial information (*Gottlieb v. Northriver Trading Co. LLC*, 872 N.Y.S.2d 46, 46-47 (1st Dep't 2009)).

Winding Up and Dissolution

- Will the operating agreement specify events that will cause the LLC's dissolution (NY LLCL § 701(a)(2))? Will the operating agreement include a deadlock sale provision to avoid dissolution in the event of a deadlock?
- Will the LLC have a limited or perpetual term? If limited, when will the term end? (NY LLCL §§ 203(e)(3) and 701(a)(1).)
- What member vote is required to terminate the LLC? The vote or written consent of at least a majority in interest of the members may voluntarily dissolve the LLC, unless the operating agreement requires a different percentage. If there is more than one class or group of members, then at least a majority in interest (or other percentage set out in the operating agreement) of each class or group must approve. (NY LLCL § 701(a)(3).)
- If the LLC has no remaining members, can the legal representative of the last member continue the LLC? Under the NY LLCL, an LLC is dissolved any time there are no members. However, unless the operating agreement provides otherwise, the LLC is not required to dissolve if the legal representative of the last remaining member agrees in writing within 180 days (or other period specified in the operating agreement) after the event that ended the last remaining member's membership to:
    - continue the LLC; and
    - become a member or have an assignee become a member.
- (NY LLCL § 701(a)(4).)
- Will certain member events cause the LLC to be dissolved? For LLCs formed on or after August 31, 1999, the death, dissolution, expulsion, retirement, resignation, or bankruptcy of a member will not dissolve the LLC unless a majority in interest of the remaining members vote to dissolve the LLC. For LLCs formed before August 31, 1999, certain member events will cause the LLC to dissolve unless a majority in interest of the members vote to continue the LLC or the operating agreement provides otherwise. For more information, see Practice Note, Dissolving an LLC (NY): Dissolution on Certain Member Events.
- Can the members revoke the decision to end the LLC, change the expiration date of the LLC, or cancel or extend the time for the event on which the LLC expires? The articles of organization and operating agreement can contain any provisions relating to members' rights not inconsistent with law (NY LLCL §§ 203(e)(7) and 417).
- Who will take care of the winding up and liquidation process? Unless the operating agreement provides otherwise, the members of a voluntarily dissolving LLC may wind up the LLC's affairs. In a judicial dissolution, on cause shown, the supreme court ordering dissolution may wind up the LLC's affairs and appoint a liquidating trustee or receiver. (NY LLCL § 703(a).)
- Will the operating agreement set out notice requirements for known creditors on dissolution? What about unknown or missing creditors? Unlike many states, New York does not require a dissolving LLC to provide notice to creditors and claimants during the wind-up phase of the dissolution. However, this is often a prudent measure. Placing creditors on notice may prevent future claims or issues, particularly if there is a dispute on the amount owed.

- How are assets distributed when liquidation occurs? When an LLC is winding up, the assets are distributed to creditors and then, unless the operating agreement provides otherwise, to members in the following order:
  - for the payment of outstanding distributions;
  - for the return of contributions; and
  - in proportion to their share in distributions.
- (NY LLCL § 704.)

Restrictive Provisions

- Is there a need for confidentiality provisions? For example, if the LLC has **trade secrets** to protect, it usually wants the members to agree to maintain them as confidential.
- Is there a need for **non-compete provisions**? Members, managers (especially officers who are managers), and other key employees are often restricted from competing with the LLC.
- If the operating agreement includes non-compete provisions, will they apply to all members and managers? Restricting competitive activities of members and managers who are also key employees of the LLC is usually more important than restricting minority investors with no involvement in the LLC's operations.
- Are there any other restrictive provisions or agreements to consider, such as restricting a member's ability to dispose of the member's interests in the LLC without consent from the other members?

Miscellaneous

- Which state's laws will govern the operating agreement? It is common to pick the state in which the LLC is formed.
- How will the operating agreement provide for the resolution of disputes among the members or among the members and the LLC? Will the operating agreement provide for a specific **venue** and jurisdiction for disputes?
- How can notices under the operating agreement be given? For example, can notices be given by email? Unless the operating agreement provides otherwise, notices of members meetings can be given by mail or personally (NY LLCL § 405(b)).
- Are any third parties entitled to any rights under the operating agreement? If not, will the operating agreement include a "no third-party beneficiaries" provision to make it clear that third parties do not have any rights under the operating agreement?
- How can the operating agreement be amended or modified (NY LLCL § 417(b))? For example, the operating agreement may allow the manager to make administerial changes to the operating agreement in the manager's discretion while requiring the approval of a certain percentage of membership interests for all other changes.

Schedules and Exhibits

- Does the operating agreement call for any schedules or exhibits?
- If so, what information is required to complete the schedules or exhibits?

Authority and Conflicts

- Is this a new operating agreement or is it an amendment to or restatement of an existing operating

agreement? If this is an amended and restated operating agreement, does it comply with the existing operating agreement's amendment provisions?
- Is the operating agreement consistent with the NY LLCL and the articles of organization? The operating agreement cannot conflict with the NY LLCL or the articles of organization (NY LLCL § 417(a)).
- Do the articles of organization need to be amended or restated? Any changes to the articles of organization require a filing with the DOS (NY LLCL §§ 211 and 214).

4.

Best Practices in Corporate Subsidiary Management

The Task of Subsidiary Management

Maintaining orderly subsidiary governance and management is necessary to:

- Provide for optimal care of the company's assets.
- Avoid a **piercing the corporate veil** between a subsidiary and its parent company, which would expose the parent company to the liabilities of the subsidiary.
- Enable prompt **due diligence** by third parties when pursuing a liquidity event (sale or an IPO).
- Have the subsidiaries ready to act as **guarantors** and grantors of **security** if the parent company must obtain debt financing.

Subsidiary management involves:

- Creating new legal entities.
- Ensuring that all subsidiaries maintain their **good standing** and qualification to do business.
- Overseeing the completion of all corporate formalities, including:
    - issuing stock to the subsidiary's stockholders or other equity holders;
    - holding meetings or obtaining written (or electronic) consents of stockholders and directors (or in the case of **limited liability companies**, of the **members** and **managers**);
    - electing the appropriate directors or managers and officers for each entity, each year; and
    - documenting all material transactions and transfers.
- Maintaining separate and complete records for all subsidiaries.

Company-Wide Processes

To ensure proper governance and management of subsidiaries, the company's corporate secretary (or legal department) must maintain central control over the creation, maintenance, and **dissolution** (when applicable) of all the company's subsidiaries. No subsidiary should be formed or dissolved without the knowledge or involvement of the company's legal department or other legal authority. To ensure that this practice is upheld, the board of directors or CEO should authorize the corporate secretary or legal department to maintain central control of subsidiaries, supported with the necessary information-management tools.

Authority

All companies, regardless of size, industry, or business, should have a policy that determines who in the organization has authority to approve and implement each corporate action.

Delegation to Executive Management

The best practice is for the board to adopt this policy. The policy should describe the business issues and items that the board delegates to the CEO (or other members of management), such as:

- Transactions up to a certain dollar threshold.
- Borrowing up to a certain dollar threshold.

- Spending within the annual budget (with some additional leeway, if desired).
- Hiring and firing of officers of a given level of seniority.
- Contracts in the ordinary course (potentially with a dollar threshold).

Delegation of Subsidiary Management

The CEO, having received broad authority from the board, typically delegates certain tasks to more junior officers or to the relevant departments. One of the tasks that the CEO should delegate is authority over the formation and maintenance of subsidiaries. Depending on the company's preference, the board policy should delegate this authority, either:

- Directly to the corporate secretary or the legal department.
- To the CEO, who then delegates it to the corporate secretary or the legal department.

Either way, the authority over the formation and maintenance of subsidiaries should ultimately be in the control of corporate counsel working either in the legal department or with the corporate secretary.

Delegation of Authority Policy

Corporate counsel should be tasked with designing, drafting, and periodically reviewing the board's delegations of authority and subsequent delegations of authority from the CEO. As noted, these delegations cover several issues, but should always include central legal-department control over subsidiary formation and management.

The delegation policy does not need to be complex or attempt to describe every contingency. Its goal is to state which officer or department is charged with what responsibilities and should be written to reflect that purpose. To that end, it should be written in as understandable a format as possible, such as:

- An organizational chart adopted by board resolution.
- A textual description adopted as a resolution (without any standalone document attached as an exhibit).

Although the board does not need to renew the policy annually, counsel should perform an annual review to ensure it is up to date.

Information Management

To maintain control over subsidiary management, counsel should create a database of all the subsidiaries' pertinent information. The database can be as simple as a spreadsheet or a more sophisticated third-party software product, depending on:

- The company's size.
- The number of subsidiaries being managed.
- The number of subsidiaries that are fully operating businesses versus shell entities formed for tax or other strategic purposes and that have few complexities to track.
- The cost of implementing a more sophisticated system, especially in light of the legal department's total budget.

Counsel should also consider the information that should be kept in the database for each subsidiary, which typically includes:

- The subsidiary's organizational information.
- The jurisdictions where the subsidiary is qualified to do business.
- The subsidiary's parent company and any other equity holders, if applicable.
- The subsidiary's directors (or managers) and officers.
- Statutory due dates for annual stockholder and board meetings.
- The due date for the subsidiary's annual **franchise tax** and report to the state.
- The service company acting as **registered agent**, if the subsidiary uses an outside service provider.

Counsel also must consider who at the company needs access to the database, and in particular:

- Whether information must be shared among separate divisions.
- How many individuals must have access to the database.
- Whether everyone who needs access works in the same office.

Ultimately, if the database is made accessible to others, counsel should implement the following policies:

- Only counsel and authorized individuals in the legal department can update the database. Others should have read-only access.
- Updates to the database require supporting formal documentation of the relevant change, such as the board's written consent or meeting minutes or copies of filed annual reports or tax returns, to ensure that the database reflects official, legally recognized changes.

Maintaining Distinct Corporate Identities

Companies manage their operational risk by creating corporate subsidiaries to conduct their businesses, including contracting with customers and suppliers and incurring debt. This corporate structure allows a parent company to:

- Have different risk profiles for different business lines.
- Shield itself from each subsidiary's liabilities and limit its exposure to the amount of its **capital contribution** in the subsidiary.

Plaintiffs asserting claims against a subsidiary often seek to disregard the corporate form of the subsidiary and hold the parent company directly liable for the subsidiary's obligations. This type of claim is commonly referred to as piercing the corporate veil. The corporate veil can be pierced if the parent company dominates the subsidiary to the point that the subsidiary shows no separate corporate interests of its own, and the plaintiff demonstrates that an injustice or wrong will likely result to the plaintiff if the corporate veil is not pierced.

Although not as common, piercing claims may be used to reach the assets of a wholly-owned subsidiary (known as reverse veil-piercing) in exceptional circumstances. In Delaware, in the context of denying a motion to dismiss, the Chancery Court held that a reverse veil-piercing claim was appropriate if the defendant's subsidiaries knowingly participated in a scheme to prevent funds to flow to their direct parent to avoid paying an appraisal judgment against the parent (see *Manichaean Cap., LLC v. Exela Tech., Inc.*, 2021 WL 2104857 (Del. Ch. May 25, 2021)).

Domination by Parent Company

When determining whether the parent company dominates the subsidiary, the courts consider factors including, but not limited to, whether:

- The parent company owns all of the stock in the subsidiary.
- The subsidiary is inadequately capitalized.
- The subsidiary's corporate formalities (such as holding annual meetings, documenting stock issuances and asset transfers, and recording board minutes and resolutions) are not observed.
- The subsidiary makes undocumented loans to the parent company or extends credit to the parent company on non-market terms.
- The parent company and subsidiary share corporate officers and directors.
- The subsidiary shares offices, employees, bank accounts, and telephone numbers with the parent company.
- The parent company pays the salaries of the subsidiary's employees or makes all human-resources decisions

- for the subsidiary.
- The parent company siphons money out of the subsidiary or accepts money intended for the subsidiary.
- The agreements and other arrangements (such as sharing of administrative services, employees, or insurance arrangements) between the parent company and the subsidiary are not arms-length transactions.
- The parent company uses the subsidiary's property as its own.
- The subsidiary guarantees debts of the parent company or any of the parent company's other subsidiaries.
- The subsidiary's contracts contain **cross-default** provisions with contracts entered into by the parent company or any of its other subsidiaries.

Several of these factors are common to companies with genuinely separate subsidiary businesses and any one factor alone does not ordinarily justify setting aside the corporate form. Moreover, the sharing of officers, directors, and a business address is often unavoidable and even advisable for the sake of maintaining efficient operations. In these cases, implementation of best practices for maintaining separate corporate identities is critical.

Avoiding Veil Piercing

A parent company can minimize the risk that a court will pierce the corporate veil of its subsidiary to reach the parent company's assets. Corporate counsel should advise the board of the steps needed to minimize the risk, some of which may require commitment from senior management of the parent company. These steps include:

- Properly capitalizing each subsidiary to only hold those assets required for its operations and any statutory capitalization requirements. This can limit the amount potentially recoverable in actions against the subsidiaries.
- Adequately insuring each subsidiary to substantially weaken the possibility that the plaintiff will suffer an injustice if the corporate veil is not pierced. Courts are less likely to permit a plaintiff to reach the assets of a parent company if the plaintiff can collect the full amount of a money judgment from the subsidiary's insurer.
- Ensuring all transactions with the subsidiary are done on an arms-length basis, including any loan to or from the parent company.
- Keeping a balance between debt and equity that is appropriate for the type of business the

subsidiary operates.
- Having the subsidiary hire its own employees, paid from the subsidiary's own funds.
- Not allowing the parent company to hire and fire the subsidiary's employees.
- Avoiding references to the subsidiary, at both the parent level and subsidiary level, as a division or department of the parent company.

Corporate counsel can oversee and implement other steps to mitigate risk, without management action, such as:
- Complying with corporate formalities.
- Properly filing each subsidiary's **certificate of incorporation** or **certificate of formation**.
- Creating a separate and independent bank account for each subsidiary.
- Keeping separate books and records for each subsidiary.
- Documenting the reasons for the subsidiary's capital structure and its levels of equity and debt.
- Fully documenting all transfers of money or other property between the parent company and subsidiary.
- Conducting separate meetings of each subsidiary's board of directors or having each board sign its own unanimous written consents.
- Filing separate tax returns and annual reports with the jurisdiction of incorporation.

The same steps that minimize risk of a court piercing the corporate veil to reach the assets of a parent company also minimize the risk of a court reverse veil-piercing to reach the assets of a wholly-owned subsidiary because traditional veil-piercing factors must be satisfied as part of the "carefully circumscribed reverse veil-piercing rule" (*Manichaean*, 2021 WL 2104857, at *12-13).

Creating Subsidiaries

Before forming a new subsidiary, the parent company's CEO or other responsible officer, with the advice of corporate counsel, must decide whether the new subsidiary is actually necessary. Creating a new subsidiary adds both organizational complexity and costs relating to formation and ongoing management. To avoid unnecessary proliferation of subsidiaries, the company should have compelling business, legal, tax, or regulatory reasons for forming any new subsidiary.

After management has decided to form a new subsidiary, counsel, in consultation with the appropriate directors and officers, considers these threshold issues:
- The subsidiary's position in the company's organizational chart, which is a function of:
  - which existing company or companies is to own the stock of the new subsidiary; and
  - what assets or businesses are to be owned or run by the subsidiary.
- The choice of entity for the subsidiary, whether a corporation, limited liability company (LLC), or **partnership**.
- The jurisdiction where the subsidiary is to be formed.

Jurisdiction of Organization

When forming a corporation, Delaware is the most commonly chosen state for many reasons, including:
- Low franchise taxes.
- Ease of filing and online services.
- Well-developed body of corporate law.

- Respected judicial bench in corporate law.
- Business-friendly statutes and decisions.

However, the decision to incorporate in Delaware is not automatic. When deciding on a jurisdiction, counsel should consider:

- Where the subsidiary will primarily transact its business.
- Whether there are any business, social, or policy reasons for choosing a particular state.
- If the subsidiary is going to conduct a regulated business in a particular state, whether it be easier to obtain the necessary state licenses if it is a domestic corporation within that state.
- Whether local employees (or local counsel) who are familiar with local laws will have legal oversight of the subsidiary.
- Whether there are tax benefits to incorporating in another state that outweigh the benefits of incorporating in Delaware.

Counsel should interview a senior officer for the new subsidiary to learn where the subsidiary is to conduct business and which of these factors should weigh most heavily. Counsel should also identify any key legal differences between Delaware and the jurisdiction under consideration, such as differences in:

- Business-combination statutes.
- Statutorily mandated indemnification for directors and officers.
- Constituency statutes that allow the board to consider interests of stakeholders other than the stockholders.

Certificate of Incorporation

When drafting certificates of incorporation for each new corporate subsidiary, counsel should consider:

- Using a standard form of certificate of incorporation for all new subsidiaries. This promotes uniformity and minimizes the chances of making errors or other changes that contravene company policy.
- Standardizing all optional provisions under Delaware (or other state) law for each subsidiary. For example, the form certificate of incorporation should reflect a standard approach to:
  - indemnification of directors and officers and advancement of their expenses for lawsuits relating to their service;
  - limitation of a director's personal liability for breaches of the duty of care, as permitted by the **Delaware General Corporation Law** (DGCL) (8 Del. C. § 102(b)(7); and
  - opting out of the business-combination statute of Section 203 of the DGCL.
- Making a separate decision for each new subsidiary as to the number of **authorized shares** to be listed in the certificate of incorporation, taking into account that:
  - if not enough shares are authorized in anticipation of future issuances, the subsidiary may later have to amend its certificate of incorporation to increase the number of authorized shares; and
  - too many authorized shares may increase the subsidiary's franchise tax unnecessarily.
- Updating the subsidiary database promptly after formation of the entity. In particular, include any deviations from the standard form certificate of incorporation, and consider adding a brief explanation with a reason for the change.

By-Laws

Corporate counsel should follow these practices for the adoption of **by-laws** for each new corporate subsidiary:

- As with the certificate of incorporation, create a standard form of by-laws for all subsidiaries to minimize mistakes.
- Interview the lead director or officer for the new subsidiary to see if there are any changes that should be made for the new subsidiary. For example, there may be reasons why the subsidiary should have different notice or **quorum** requirements.

For any subsidiary formed outside the jurisdiction of corporate counsel's expertise, consult with local counsel to ensure the form of the certificate of incorporation and by-laws complies with the law of the jurisdiction of formation.

Organizational Resolutions and other Post-Formation Tasks

After filing the certificate of incorporation with the appropriate state office, counsel should implement the immediate post-formation tasks, including:

- Signing the organizational action of the incorporator.
- Holding the first meeting of the subsidiary's board of directors or obtaining their unanimous written (or electronic) consent to the subsidiary's organizational resolutions.
- Issuing stock to the subsidiary's stockholder or stockholders.

The organizational resolutions should cover:

- Ratification of the actions of the incorporator.
- Adoption of the subsidiary's by-laws.
- Appointment of the subsidiary's initial officers.
- Adoption of a form of the subsidiary's stock certificate.
- Issuance of stock to the subsidiary's stockholder(s).
- Adoption of the subsidiary's **fiscal year**.
- Authorization for the officers to open bank accounts, sign documents on behalf of the subsidiary, and take other actions in furtherance of the business.

Capitalizing the Subsidiary

To protect against the appearance of domination by the parent company, the subsidiary must be adequately capitalized. To document a cash contribution to the subsidiary, the board of the parent company should pass a resolution to make the contribution in return for an issuance of stock.

If the parent company intends to move an existing business into the control of a new subsidiary, counsel should consult with the appropriate directors and officers to determine:

- Which existing company or companies should be the stockholders of the new subsidiary.
- What assets the subsidiary should own.

These decisions should be made before formation. The contribution of assets to the subsidiary should be documented in a contribution agreement that is executed by both the parent company and subsidiary and approved by the boards of both.

Ongoing Maintenance of Subsidiaries

Following formation, corporate counsel must ensure that the subsidiary continues to meet its legal requirements for conducting business, and that it follows all corporate formalities to protect against veil-piercing claims.

Good Standing

Counsel must ensure that each subsidiary is in good standing. An entity is typically in good standing if it is up to date on its franchise taxes and required reports. Counsel must therefore know the following for each subsidiary:

- When the report to the state is due. Depending on the jurisdiction, the subsidiary may be required to file a report:
  - annually;
  - on the occurrence of certain events, such as a change in capital structure; or
  - never.
- States may not treat all entities in their jurisdiction uniformly. For example, Delaware corporations file an annual report and pay franchise tax, but LLCs and partnerships only pay a flat annual tax and are not required to file a report.
- Who in the company is responsible for filing the report. For example, if the report is filed with:
  - the secretary of state (as, for example, in Delaware), the legal department should file it; or
  - the state's revenue department, the company's tax department should file it.

Because the franchise tax and report requirement varies for many subsidiaries, counsel should put this information on a summary sheet in the front of the subsidiary's minute book.

Foreign Qualifications

In addition to maintaining its good standing in the jurisdiction of its organization, each subsidiary must qualify to do business and maintain its qualification to do business wherever it conducts business. When applying for and maintaining a subsidiary's **foreign qualification**, counsel is usually responsible for:

- Checking the name availability of the entity in the states where the subsidiary is to conduct business.
- Preparing and filing the certificate of authority with the state, either directly or through a service provider.
- Paying filing fees, either directly or through a service provider.
- Determining if maintaining the subsidiary's foreign qualification requires the annual payment of fees or filing of reports, and if so, which company department is responsible for the filing.

"Doing Business As" Names

If the subsidiary has any assumed or d/b/a names, counsel should also determine if the name must be renewed or if it is perpetual. If the name expires, counsel should record the due date for the necessary renewal filing on the company's summary sheet and in the database.

Annual Stockholder Meetings

Each subsidiary should hold an annual stockholders' meeting or have the stockholder or stockholders execute a unanimous written consent in lieu of an annual meeting. A subsidiary should not skip this step just because it is wholly owned by a parent company, as that would create an opening for a claim to pierce the corporate veil.

Counsel should consider implementing these practices:

- Create form consents that are appropriate for each state.
- Ideally, the parent company should complete a separate consent for each subsidiary, rather than combining consents for multiple subsidiaries owned by the same parent company. If circumstances demand combining multiple subsidiaries into one consent, counsel should:
    - ensure the subsidiaries are all organized in the same jurisdiction and owned by the same parent company; and
    - provide a separate copy of the combined consent to be signed by the parent company (stockholder) for each subsidiary so that an original signature can be kept in each subsidiary's minute book.
- For ease of management, elect the same set of directors for each subsidiary unless there is reason to change the slate. Consider whether the same directors can serve for all subsidiaries, or for all subsidiaries within each line of business or geographic area. The approach for electing directors varies by company, depending on the parent company's way of doing business. The company may also be subject to industry or professional regulations that impose licensing or other qualifications that preclude certain individuals from serving as directors.
- Do not automatically insert the names of the same directors into the stockholder consent each year. Have an annual discussion with each director to establish if they are on the boards of the right entities based on their current duties and responsibilities.
- Counsel should not serve as a director of any entity. Counsel should avoid situations in which its legal representation of the company could diverge from its **fiduciary duties** as a board member. For example, if the subsidiary were to become insolvent, counsel may have a fiduciary duty as a director to the subsidiary's creditors, while still having a duty as legal counsel and an employee to the parent company, the subsidiary's stockholder.
- If any subsidiary is not wholly owned and an action is taken without a meeting by less than unanimous consent of the subsidiary's stockholders, provide notices under Section 228(e) of the DGCL (or its equivalent in the subsidiary's jurisdiction of formation) to the non-consenting stockholders.

Although appointing the same individuals to the boards of all subsidiaries is a factor in weighing veil-piercing claims, it is not determinative of those claims, even when combined with the parent company's control through stock ownership and board control. A more significant factor is the parent company's concentration of control over the day-to-day business decisions of the subsidiary.

Board Resolutions

Shortly after formation, the board of the new subsidiary should adopt organizational resolutions.

For future board action, counsel should implement these practices:

- Have the directors execute written consents at least annually, to demonstrate their continued engagement with the subsidiary's affairs and that the subsidiary is not a shell for the parent company.
- Use one of the regular board consents to appoint subsidiary officers each year.
- Do not automatically reappoint the same officers each year. Have an annual discussion with each officer to confirm that they are appointed to the appropriate entities based on their current employment responsibilities.
- Obtain board approval by written consent or at a meeting for every stock and asset transfer, even those among affiliates.
- Obtain board approval by written consent or at a meeting for every material contract and every significant corporate action.
- Include in all written consents and minutes a catch-all resolution approving all actions so far taken and to be taken by the officers in furtherance of the approved action.
- Do not backdate documents if approval for an action is given after the action is taken. Use the catch-all resolution described above.
- Write all consents and resolutions in plain English. Use as little formalistic legal language as possible, including lengthy WHEREAS clauses.

In Delaware, unless restricted in the corporation's certificate of incorporation or by-laws, written board consents can also be signed and delivered electronically (DGCL § 116(a) and §141(f)).

Minute Book

The best practice for organizational purposes is to maintain a separate minute book for each subsidiary. The minute book should contain the originals of all organizational documents, signed consents and minutes, the corporate seal, and the stock ledger.

Counsel should update the stock ledger with each issuance and transfer of stock. Each entry on the ledger should document the record date and owner for each action. Counsel should also maintain the originals of all issued stock certificates with the stock ledger and minute book of the parent entity receiving the stock.

Counsel should also create a summary sheet that goes in the front of the minute book. The summary sheet should list:

- The names of the subsidiary's current directors (or managers, or the general partner, as applicable).
- The names of the subsidiary's current officers.
- For corporations, the number of shares authorized for issuance and the number of shares issued and outstanding.
- The identity of subsidiary's parent company and any other stockholders, if applicable.
- The service provider acting as registered agent, if applicable, and the address for service of **process**.
- The amount of the subsidiary's annual franchise taxes (an amount that may need updating yearly based on how the jurisdiction of incorporation calculates the required franchise tax) and the company department responsible for payment.
- The subsidiary's state-reporting requirement and due date, if any, and who is responsible for filing.

- The subsidiary's foreign qualifications and any associated fees or due dates.
- The subsidiary's d/b/a names, jurisdictions of use, and related filing due dates, if any.
- A description of the purpose of the subsidiary, including who requested and who approved its formation.

Counsel should review and update the summary sheet annually. If the company has an electronic database, counsel may find it more convenient to maintain this information there, eliminating the need to include a paper copy in the minute book. As part of the annual review, counsel should also confirm that the subsidiary's corporate formalities have been met, its taxes paid, and its reports filed.

One benefit of the summary-sheet system is that if an officer leaves the company, counsel can quickly look up which companies the officer served and arrange for the replacement to be appointed, if necessary. An electronic database also makes this task easier to complete.

Consider including a capitalization table in the minute book if the subsidiary is not wholly owned by the parent company.

5.

Key Negotiating Points in Private Acquisition Agreements Comparison Chart

1. Representations and Warranties

Representations and warranties are statements of fact and assurances made by the parties. They are usually the longest part of the acquisition agreement and often take a significant amount of time to negotiate. The buyer and seller generally negotiate the scope of the representations and warranties. The buyer's goal is to get comprehensive representations and warranties because they are a valuable source of information about what the buyer is purchasing and form the basis for the buyer's right to indemnification for any problems or unforeseen risks and constitute part of the closing conditions. Conversely, the seller wants to give as few representations and warranties as it can and limit the scope of the representations and warranties it has to give.

The seller can limit the representations and warranties in the following ways:

- **Materiality:** Qualify a representation or warranty by what is material or what might cause a material adverse effect.
- **Knowledge:** Qualify a representation or warranty by what a party knows or should know.
- **Scope:** Limit a representation or warranty to certain material. For example, the representation or warranty may be limited to the materials identified in the data room.
- **Time:** Make a representation or warranty as of a specified date or time or for a particular period.
- **Disclosure schedules:** Limit a representation or warranty by reference to the disclosure schedules.

The particular representations and warranties in the table on the next page are frequently the subject of negotiation.

Name of Provision	**Buyer Favorable**	**Seller Favorable**
No Undisclosed Liabilities Representation This representation protects the buyer against unknown liabilities by shifting the risk of unknown liabilities to the seller.	A buyer wants the seller to represent and warrant that there are no target company liabilities (contingent or otherwise) other than those expressly identified on a disclosure schedule, reflected or reserved against on the face of the balance sheet, or incurred in the ordinary course of business since the date of the most recent balance sheet.	A seller wants to narrow the scope of the representation and warranty. In particular, the seller wants to limit the nature and type of the liabilities required to be disclosed to the buyer to liabilities which would be required to be disclosed as a liability on a balance sheet prepared in accordance with **GAAP**. As a general rule, GAAP requires an accrual associated with a contingent liability if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Therefore, this framework excludes unknown contingent liabilities from coverage.
Full Disclosure/(10b-5)	A buyer wants to include a 10b-5	A seller wants to exclude any 10b-5 or full

Representation The full disclosure (10b-5) representation is based on **Rule 10b-5** promulgated under the **Securities Exchange Act of 1934**. Rule 10b-5 makes it unlawful, in connection with the purchase or sale of any security, for a person to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."	representation and expand it to require full disclosure, with no knowledge qualifier, of any fact that would materially adversely affect the assets, business, or financial condition of the target company or its business. The buyer's right of recovery for a breach of a 10b-5 contractual representation is broader than the buyer's right of recovery under Rule 10b-5, because to prevail in a Rule 10b-5 securities fraud action, a buyer must prove, among other things, that the seller acted with scienter and that the injured party reasonably relied to its detriment on the representation or non-disclosure.	disclosure representation. However, if the representation is included, the seller should seek to limit it to the language of 10b-5 ("make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading") and resist any expansion of the scope. If the representation is expanded to cover any fact that could have a material adverse effect on the target company or its business, the seller should seek to insert a knowledge qualifier.

2. Closing Conditions

If there is a time gap between signing and closing, each party requires the other to fulfill certain conditions before the transaction closes. Usually there are conditions that both parties must satisfy and conditions that only bind one of the parties. If a condition of a party is not satisfied, that party is typically not required to close the transaction until the condition is satisfied. A party can always waive its own closing condition.

The particular closing conditions set out in the table on the next page are frequently the subject of negotiation.

Name of Provision	**Buyer Favorable**	**Seller Favorable**
Bring-down of representations and warranties (issue of when) The bring-down of representations and warranties provides the buyer with the right to walk away from the deal if any of the seller's representations are inaccurate. The buyer and the seller often negotiate on what date the representations and warranties must be accurate.	A buyer should ask that the representations and warranties be accurate as of the signing and as of the closing. This is important because a buyer values the target based on certain assumptions, including the accuracy of the representations and warranties as of the signing.	A seller prefers to only measure the accuracy of the representations and warranties as of the closing date to enhance the certainty of closing. A seller should consider including an updating mechanism for the disclosure schedules.
Bring-down of representations and warranties (issue of how accurate) The buyer and the seller also often negotiate how accurate the representations and warranties must be when they are brought down.	Ideally, a buyer wants the representations and warranties to be "accurate in all respects." However, a buyer typically cannot obtain this standard for all representations and warranties. Typically, certain fundamental representations and warranties (such as organization and authority, capitalization, ownership of shares, taxes, and less frequently, employee benefits and environmental matters) must be accurate in all respects or accurate with a de minimis exception. The remainder of the representations and warranties must be accurate in all material respects or accurate except where the inaccuracy would not constitute a material adverse effect. The buyer should ensure that it is not subject to a double materiality standard for representations that are already	A seller wants to subject any bring-down of representations and warranties to a materiality or material adverse effect qualification. Otherwise, the seller risks uncertainty of closing over immaterial breaches. However, the seller typically agrees to subject certain fundamental representations and warranties that are within its control to an "accurate in all respects" standard or accurate with a de minimis exception (such as organization and authority, capitalization, ownership of shares, taxes, and less frequently, employee benefits and environmental matters).

	qualified by materiality. This is why representations that are subject to a materiality qualifier should be accurate in all respects, rather than accurate in all material respects. Another approach that can be taken is to disregard (read out) materiality and material adverse effect qualifiers for all representations and require the representations to be accurate, in all material respects or accurate except where the inaccuracy would not constitute a material adverse effect. The buyer should also seek a provision eliminating double materiality in the indemnification section.	
Stand-alone material adverse effect (MAE) condition The stand-alone MAE condition gives the buyer the right to walk away from the transaction if there has been a target company MAE between the date of signing and the date of closing.	A buyer often includes this as a separate condition because it provides an additional right not to close the transaction. However, as evidenced in MAC-related cases such as *Hexion Specialty Chemicals v. Huntsman Corporation* (965 A.2d 715 (Del. Ch. 2008)), it is difficult for buyers to prove that an MAE has occurred; though the finding of an MAE is not unprecedented in light of *Akorn, Inc. v. Fresenius Kabi AG* (2018 WL 4719347 (Del. Ch. Oct. 1, 2018), *aff'd* 2018 WL 6427137 (2018)).The standard of proof for an MAE is high, and the burden of proof falls on the buyer. If a buyer wants more certainty as to what would constitute an MAE, the buyer can identify objective criteria or metrics (such as financial or operational targets) and include them in the definition of MAE. For example, the buyer could provide that, without limiting the generality of the other parts of the MAE definition, the failure of the business to achieve a specified amount of EBITDA, earnings per share, revenue, or other income statement results for specified pre-closing periods constitutes an MAE.	A seller wants to exclude any separate MAE condition to closing and can argue that the buyer should be protected by the bring-down of the representations and warranties. Because buyers rarely succeed when the parties litigate the issue of whether an MAE has occurred, the seller wants to keep the standard MAE condition formulation. If the seller agrees to include objective criteria or metrics (such as financial or operational targets) in the definition of an MAE, it can provide that multiple triggers must be met before the buyer can refuse to close the transaction. For example, multiple triggers might include that there has been a 20% decline in the target's **EBITDA and** the target has lost any one of the customers listed on a schedule to theagreement.

3. Definitions

Defined terms are used in acquisition agreements for structure and clarity. The particular defined terms set out in the table below are often heavily negotiated because they serve to allocate risk between the parties.

Name of Provision	Buyer Favorable	Seller Favorable

Material Adverse Effect (MAE)
 	
How the parties define a "material adverse effect" is significant for purposes of determining whether a condition to closing has been satisfied and for interpreting the application of qualifiers to the representations.
	As mentioned above, the burden of proof standard for an MAE is high and a court is unlikely to find that an MAE has occurred using the standard formulation. However, the buyer can try to negotiate the following:
	
	• Include "prospects" in the definition so that an MAE means "any change, event, occurrence, or condition that has a material adverse effect on the business, assets, liabilities, financial condition, results of operations, or **prospects** of the Company."
	• Eliminate or scale back any seller carve-outs to the definition of MAE for general economic changes or conditions, industry wide changes or conditions, war, terrorism, or otherwise generally applicable or deal-related risks.
	• If pro-seller carve-outs are accepted (as described in the above bullet), exclude any circumstances that "disproportionately affect" the target from those carve-outs.
	• In addition, buyers may try to further shift the risk to the seller by:
	    • affirmatively allocating the burden of proof to the seller;
	    • expressly providing that any change, event, occurrence, or condition **whether known or unknown** at the time of execution of the agreement will be considered in the determination of whether an MAE has occurred;
	    • applying the MAE definition to what "could have" or "is reasonably likely to have" an
		A seller can try to narrow the MAE definition by:
		
		• Deleting any reference to "prospects."
		• Including carve-outs for changes in law and general economic changes or conditions, industry wide changes or conditions, war, terrorism, and otherwise generally applicable risks. The seller can also try to include carve-outs for an MAE resulting from:
		    • the announcement of the transactions contemplated in the acquisition agreement;
		    • changes that the buyer knew about;
		    • changes in GAAP or law;
		    • changes to the credit markets in general, including changes in interest rates or the availability of financing;
		    • the target company's failure to meet internal or published projections, forecasts or revenue or earning predictions for any period; or
		    • changes in political conditions.

	MAE, as opposed to "has" or "would have" an MAE; • specifying the time period (for example, since the balance sheet date) in which the effect should be measured. Otherwise courts look for proof that an MAE is "durationally significant;" or • specifying that a failure to meet objective criteria such as a particular milestone or financial metric would constitute an MAE.	
Knowledge One important function of representations and warranties is to allocate risk between a buyer and a seller. In connection with allocating risk, a seller will attempt to mitigate its exposure by limiting the scope of its representations and warranties. One of the principal ways a seller can limit its exposure is by qualifying representations and warranties by knowledge.	A buyer wants knowledge to be defined as constructive knowledge so that the seller will be deemed to know what it would have known with a reasonable investigation. If the seller limits knowledge to a particular subset of people (one or two specific individuals, all senior executive officers, all employees, and so on), the buyer should ensure this group is not too limited and that it includes people who are knowledgeable about the target's operations.	A seller wants knowledge to be defined as actual knowledge so that there is no investigation requirement and no uncertainty as to the application of the standard (for example, what is actually known by an individual as compared to what the individual should have known after an investigation). If the buyer succeeds in a constructive knowledge definition, the seller should limit this investigation obligation to a discrete group of senior management and attempt to limit the investigation to inquiry of such person's direct reports in the target business.

4. Indemnification

While the representations and warranties provided by a seller in an acquisition agreement create the basic structure for allocating risk between a buyer and a seller, the foundation of that structure is the strength of the indemnification standing behind those representations and warranties. The indemnification provisions set out in the table below are frequently negotiated.

Name of Provision	Buyer Favorable	Seller Favorable
Sandbagging In connection with an acquisition agreement, a buyer typically conducts a substantial amount of due diligence on the target and its business. However, despite this investigation, a seller is required to make representations and warranties concerning the target and its business and is permitted to set out certain exceptions to its representations and warranties on the disclosure schedules. There may, however, be facts, events, or circumstances that, although known to a buyer, are not set out on the disclosure schedules and for which a buyer would be permitted to bring a claim for indemnification after the closing (because a representation and warranty of the seller would be inaccurate as a result of the existence of these facts, events, or circumstances). This right of a buyer to bring an indemnity claim based on breaches known before closing is referred to as sandbagging.	A buyer wants the agreement to explicitly state that there is no limit on its remedies based on preexisting knowledge of an inaccuracy or breach. As a compromise, the buyer may agree to remain silent on the issue of sandbagging. However, courts in different jurisdictions interpret this silence differently. Many jurisdictions (including New York) interpret this silence in favor of the seller in certain circumstances and the buyer should agree to remain silent on the issue only with an understanding of the implications in doing so.	A seller wants to expressly limit the buyer's remedies based on preexisting knowledge of an inaccuracy or breach. As a compromise, the seller may agree to remain silent on the issue of sandbagging. Many courts (including New York courts) will interpret this silence in favor of the seller in certain circumstances. It is, therefore, important for counsel to confirm how the applicable state is likely to rule on this issue and in what circumstances silence will benefit the seller's position.
Survival This provision provides an expiration time for indemnification claims made under the representations and warranties	A buyer wants to expand the survival period. Buyers should negotiate for certain representations and warranties, such as tax, employee benefits, and environmental matters, to have a longer or unlimited survival period. Sometimes	A seller seeks to limit the duration of survival of the representations and warranties, or if a seller has substantial leverage, provide that the representations and warranties do not survive the closing for any period.

section. Survival periods usually range from six months to three years (12 to 24 months is most common).	these representations have a survival period of the applicable statute of limitations for the claim plus a reasonable period (often 60 days). A buyer also wants to provide that the survival period is unlimited for fundamental representations and warranties (such as organization and authority, ownership of shares, and capitalization).	
Type of damages The parties often negotiate what type of damages can be recovered in the definition of "Damages" or "Losses."	A buyer wants the definition of damages or losses to be as broad as possible and tries to include consequential and similar damages and an express reference to diminution in value. If a buyer has substantial leverage, it can try to expressly include punitive damages, but this is not common. Because a seller resists this inclusion, a buyer sometimes compromises by remaining silent on the issue or including a qualitative limitation that only applies to direct claims (and not to third party claims).	A seller wants to expressly exclude punitive, consequential, and similar damages and may seek to exclude diminution in value damages. Because a buyer resists this express limitation, a seller sometimes compromises by remaining silent on the issue or including a qualitative limitation that only applies to direct claims (and not to third party claims).
Baskets and deductibles **Baskets** and **deductibles** are designed to provide a seller with assurance that, even in the event of breach of a representation or warranty, the seller will not be bothered for immaterial claims. In the case of a basket or threshold, when the buyer's losses exceed the agreed-on basket or threshold amount, the seller is liable for the total amount of the losses. In the case of a deductible, when the	A buyer, ideally, prefers no basket or deductible because it is a limitation on its right to indemnification. However, because this type of limitation is common, the buyer will likely accept the concept and instead negotiates the size and exceptions to the basket or deductible. A buyer prefers a basket or threshold over a deductible because once the threshold is hit, the seller is liable for the total amount. A buyer can try to lower the dollar amount of any basket or threshold (at or	A seller wants to include a basket or deductible. Of the two, sellers prefer a deductible because when the buyer's losses exceed the agreed-on deductible amount, the seller is liable only for the amount of the losses that exceed the deductible. A seller wants the basket or deductible amount to be as high as possible. The seller may also try to negotiate a mini basket. A seller also wants to limit any carve-outs to the basket or deductible.

buyer's losses exceed the agreed-on deductible amount, the seller is liable only for the excess amount of the losses above the deductible. A combination of a basket or threshold and deductible is sometimes used. After the parties have concluded that a basket or deductible is appropriate, the parties are then left to determine the amount to set for the basket or deductible (which may be based on a percentage of the transaction value).	below 1% of deal value is common). A buyer also wants to avoid any additional smaller baskets for *de minimis* claims (known as **mini baskets**). A mini basket prohibits any claim below a certain amount. Normally, these claims do not count toward baskets or deductibles. A buyer should try to carve out covenants and fundamental representations and warranties (such as organization and authority, ownership of shares, capitalization, taxes, and less frequently. employee benefits and environmental matters) from the basket. If there is an agreement that the seller will take full responsibility for a particular liability (such as specified litigation), the buyer should ensure that the liability is not included in the basket. The buyer should ensure that it is not subject to a double materiality standard for representations that are already qualified by materiality. The buyer should insert a provision that contains a read out of materiality and material adverse effect qualifiers for the purpose of indemnification.	
Cap A cap limits the seller's indemnification obligation. It may be a set dollar amount, but is typically based on a percentage of the transaction value.	A buyer, ideally, prefers no cap because it is a limitation on its right to indemnification. However, because this type of limitation is common, the buyer will likely accept the concept and instead negotiate the size and exceptions to the cap. A buyer can try to increase the size of the cap (approximately 10% is common). A buyer should try to carve out covenants and fundamental representations and warranties (such as organization and authority, ownership of shares, capitalization, taxes, and less frequently, employee benefits and environmental matters) from the cap. If there is an agreement that the seller will take full responsibility for a	A seller wants to include a cap and wants the cap amount to be as low as possible (approximately 10% of deal value is common). A seller also wants to limit any carve-outs to the cap.

	particular liability (such as specified litigation), the buyer should ensure that the liability is not included in the cap. If there are certain liabilities that have potential to be high (such as environmental liabilities or products liabilities), the buyer may also try to negotiate those as cap exclusions or separate caps.	
Exclusive Remedy Agreements can provide that indemnification is: • The exclusive remedy. • The exclusive remedy except in certain situations. • A non-exclusive remedy (meaning that other remedies in equity and for contractual breach are available). Alternatively, the parties can remain silent as to whether or not it is the exclusive remedy.	A buyer would rather provide that indemnification is the non-exclusive remedy or remain silent. However, this point is typically difficult to win. Most buyers agree to an exclusive remedy provision, but negotiate certain exclusions for equitable remedies, fraud, willful breach, and intentional misrepresentation.	A seller wants to provide that indemnification is the exclusive remedy with limited exceptions. Otherwise the seller could risk rendering negotiated limits to indemnifications less meaningful (such as caps and baskets). A seller typically agrees to certain exclusions (such as for equitable remedies, fraud, willful breach, and intentional misrepresentation). It is particularly difficult for a seller to argue that fraud must be subject to any indemnification limitations; however, sellers will attempt to limit this exclusion by narrowly defining “fraud” for purposes of the acquisition agreement to require the seller’s intent to deceive with respect to the subject matter of a representation or warranty set forth in the acquisition agreement.
Escrow/Holdbacks The parties sometimes agree to hold a portion of the purchase price in escrow for a certain period of time to satisfy future indemnification claims. As an alternative to an escrow, the	A buyer wants an escrow or a holdback because either assures the buyer that there will be readily accessible funds to pay indemnification claims. Although less common than escrows, a buyer prefers holdbacks over escrows because the buyer retains control over the funds.	A seller objects to escrows or holdbacks because it wants to extract as much deal value as possible at closing. A seller prefers escrows to holdbacks because the money is held by an independent escrow agent and is easier to recapture upon expiration of the escrow period.

buyer can holdback a portion of the purchase price to cover future claims.	Once a buyer can negotiate an escrow or a holdback, the buyer should ensure that the dollar amount is large enough to cover any material issues. The buyer should also ensure that the funds are held in escrow (or held back) for a sufficient period of time (usually matching the survival period associated with non-fundamental representations).	If a seller does agree to an escrow or holdback, it wants either to be for as small a percentage of the purchase price as it can negotiate and to ensure that the funds are released in a reasonable period of time. If the seller agrees to an escrow, it can propose that the escrow serve as the exclusive source for recovery of indemnification claims. In this case, the escrow amount serves as a cap on the total amount of recovery available for indemnification claims.