A Message from the Section Chair

This article relates in part to pending legislation. Further developments may occur between the date this article was submitted for publication and the date this *Journal* was distributed. The reader is cautioned to check for updates.

New York's Limited Liability Company Law Takes A Big Step In The Wrong Direction

New York imposes a burden on new businesses that almost no other state does. Amazingly, New York's legislators are hard at work increasing that burden rather than decreasing it.

In nearly every state except New York, anyone can form a limited liability company[1] (an "LLC") by just filing a piece of paper with a state official and paying a small fee. Only New York and a tiny handful of other states[2] require LLCs to take a further step: they must publish in a newspaper an official notice of formation.[3] Publication of LLC notices in New York costs $1,000 to $2,000 per LLC, plus legal, paralegal, or service company fees—significant for anyone starting a small business. These costs also become meaningful for commercial transactions with many new LLCs. Even if a transaction requires only one new LLC, publication creates an annoyance and an opportunity for error.

The entire exercise serves no purpose, though. If anyone wanted to find out about an LLC, why would they ever dig through legal notices in newspapers? They can already find out about any LLC 24 hours a day through the Secretary of State's website.[4]

Against that backdrop, and given New York's supposed desire to make it easier to do business here,[5] one would expect New York to seize any opportunity to eliminate requirements that are antiquated, unnecessary, expensive, and nearly "unique to New York." But one would be wrong. Instead, New York has taken a big step backwards by increasing rather than decreasing its publication requirements for LLCs. Even worse,

a State Senate leader has just introduced legislation that would take a further step in the same wrong direction.

Effective June 1, 2006, Chapter 767 of New York's Laws of 2005[6] makes these changes in New York's publication requirements for LLCs[7]:

- *Fewer Weeks.* An LLC must publish its notice of formation for four weeks, not six (an improvement, but keep reading).[8]
- *Quasijudicial Publication.* The notice must be published as if it related to a judicial proceeding[9]—which limits the number of newspapers where the notice may appear, hence should drive up the cost of compliance.
- *Top Ten Disclosure.* An LLC must disclose in its published notice the ten persons who are "actively engaged in [its] business and affairs" and hold the "most valuable" interests in the LLC.[10]
- *Hedge Funds.* The "top ten" disclosure requirements do not apply to investment advisers, commodity pool operators, commodity trading advisors, or funds they operate.[11]
- *Suspension of Authority.* If an LLC does not complete publication within 120 days after formation, its authority to do business will be suspended. The LLC can reinstate its authority by accomplishing the required publication.[12]
- *Fee Doubling.* Once an LLC complies with the publication process, it will now pay twice as much to file a certificate of compliance.[13]

None of this serves any useful purpose that the author can identify.[14]

At the time of writing, additional legislation had been introduced—and was rumored to be on the fast track to passage—to further worsen New York's LLC publication requirements. By the time this column appears in print, that legislation, Senate Bill 6831,[15] may have passed, changed, died, or remained pending with no action at all.[16]

Senate Bill 6831 would cut back some of the more egregious requirements of Chapter 767[17] and undo the one improvement it makes.[18] But Senate Bill 6831 would add an astounding new provision of its own:

> [I]f [an LLC] formed after [June 1, 2006] fails to comply with the publication and filing requirements of [LLC Law § 206(a) as modified] within [120 days,] each member of such [LLC] shall be personally and fully liable, jointly and severally with such [LLC] and with each other member, if any, of such [LLC], for all debts, obligations and liabilities of such [LLC] incurred or arising at any time before or after such failure. However, if [an LLC later complies with the publication requirements], this paragraph shall not apply to such [LLC] or to

> the member or members of such [LLC], and the member or members of such [LLC] shall have no liability by reason of this paragraph for the debts, obligations and liabilities of such [LLC].[19]

This language would thus impose a punishment—personal liability—that should cause great concern for anyone who might use an LLC in New York. Even if members could terminate personal liability by making sure their LLC writes the necessary checks to the newspaper industry, the mere possibility of personal liability seems entirely excessive under the circumstances. It would take New York's almost-unique LLC publication requirements from the ridiculous to the absurd.

Aside from serving no purpose[20] and imposing a burden almost no other state imposes, the personal liability proposed in Senate Bill 6831 would raise legal issues and practical concerns from A to Z, starting with these:

- *Automatic Stay.* If the members become personally liable because the LLC failed to publish, what happens if a creditor files bankruptcy before the failure to publish has been cured? Would the automatic stay protect the creditor from losing its claims against personally liable members?
- *Constitutional Law.* If Wyoming says the members of a Wyoming LLC have no personal liability, does New York have the authority to decide they do have personal liability? This new statute could drag the United States Supreme Court into its interpretation and application—an amazing feat for a trivial but bloated statute on business entity formation.
- *Debtor-Creditor Issues.* If a member of an LLC becomes personally liable for some huge amount of LLC indebtedness, would the member become "insolvent" for purposes of debtor-creditor and other laws? What consequences would follow?
- *Estoppel.* What if an LLC's creditor relied on a member's personal liability, and the member knew of such reliance? Would the member be estopped from disclaiming personal liability?
- *Judgments.* If a creditor obtains a judgment against a personally liable member before the company cures its failure to publish, can the creditor still enforce the judgment against the member after the LLC solves the problem?
- *Layering.* Cautious investors (e.g., pension fund trustees) may establish extra Delaware LLCs just to insulate themselves from potential personal liability in case something goes wrong under New York's publication statute. These new entity layers would add complexity, extra work, and extra opportunity for error.[21]
- *Nonrecourse Carveouts.* Nonrecourse borrowers should ask their lenders to waive any claims for personal liability resulting from failure to publish properly. The same goes for landlords negotiating leases with tenants. But is an LLC member's "statutory liability" waivable?
- *Opinions.* What new assumptions and verbiage would we need to add to routine opinions for loan closings? What about nonconsolidation opinions for securitized loans? How much time would we need to spend negotiating those ridiculous new assumptions and verbiage?
- *Service Provider Liability.* If an LLC fails to comply with the publication requirements and any of the risks suggested here befall(s) any of the LLC's members, would they have a claim against the LLC's counsel or filing service? For how much? Will this exposure further increase the cost of forming LLCs?
- *Technical Errors.* If an LLC publishes its notices in a slightly wrong newspaper, or omits or misstates some minor technical detail of the required information, do all the LLC members become personally liable? Is there any concept of "substantial compliance"? What would that require?
- *Title Insurance.* If an LLC member sells real property, does the "creditors' rights exclusion" in the buyer's title insurance policy cover problems if the LLC doesn't properly publish and the seller becomes liable for huge LLC obligations and hence insolvent?
- *Who Can Cure?* If the managing member of an LLC fails or refuses to make the required publication, can any member do so? Will the members have all the information they need? What if multiple members try to make the required publication, and some don't do it right? Which publication governs in determining the members' personal liability?

These and other fascinating questions could support a series of law review articles, perhaps an entire symposium issue on the implications and penumbras of New York's LLC publication requirements. The business community may ultimately find it can live with the answers to all these questions. But the mere possibility of any personal liability, even temporary personal liability, should be off limits.

Whether or not the Legislature adopts Senate Bill 6831, New York's nearly unique publication requirements for LLCs are already out of control—an embarrassment. The New York business and legal communities should not only try to persuade the Legislature to repeal Chapter 767 and ignore Senate Bill 6831, but also take the obvious and

appropriate next step: repeal all publication requirements for LLCs.

These requirements serve no purpose beyond imposing needless expense on new businesses[22]; showing that New York is almost uniquely hostile to business formation; running up legal and paralegal fees for doing useless work[23]; promoting use of Delaware entities whenever possible[24]; and helping to drive businesses out of New York.

The author hopes and believes RPLS will work actively with the Business Law Section and anyone else who wants to eliminate all publication requirements for LLCs in New York.

Endnotes

1. Every statement about New York LLCs in this column also applies to limited partnerships, registered limited liability partnerships, and professional service limited liability companies.
2. Limited research found only two other states with publication requirements. Ariz. Rev. Stat. § 29-635; Neb. Rev. Stat § 21-2653. Delaware, the entity formation state of choice, has no such requirements. *See* Del. Code Ann. tit. 6, §§ 18-101 to 18-1109.
3. When a non-New-York LLC qualifies to do business in New York, it faces a similar publication requirement.
4. Visit http://www.dos.state.ny.us. Click on "Search for Corporations or Business Entities," a couple of inches below the photograph of Gov. George Pataki.
5. *See, e.g.,* "New York Ranks Last in Tax Study," N.Y. Sun, Feb. 27, 2006, at 1 (noting "Governor Pataki's claims that the state under his stewardship has made substantial gains in making itself more appealing to businesses and entrepreneurs.")
6. Laws of New York, 2005, Ch. 767 (enacted February 3, 2006) ("Ch. 767"). The same new burdens apply to LLCs, limited partnerships, registered limited liability partnerships, and professional service limited liability companies. The burdens apply to new entities, foreign entities qualifying in New York, and previously formed entities that did not properly publish. The statute repeats in full all requirements for each entity type—once for new entities and again for old ones that didn't properly publish. The miracles of multiplication thus inflate the statute to 36 pages of single-spaced text, a model of incomprehensible legalese. See http://www.nationalcorp.com/pdfs/NY_Chapt_767.pdf. In comparison, the United States Constitution, with all amendments, occupies about 19 pages. See http://www.usconstitution.net/const.txt. Ch. 767 also far exceeds in length the entire LLC laws of most states. In contrast, Arizona uses 74 words (6 lines of text) to express its LLC publication requirements and Nebraska 293 (31 lines).
7. Ch. 767, Sec. 24 (statute effective immediately after the calendar month that includes the date 90 days after enactment). The Secretary of State's office has informally confirmed the June 1 effective date.
8. Although Ch. 767 reduces the number of required publications by a third, other provisions more than outweigh this benefit. *See* Ch. 767, Sec. 3, about 1 inch into the paragraph (modifying LLC Law § 206). Because section 3 consists of a single long paragraph occupying more than two pages of text in Ch. 767, a ruler offers the best way to cite any specific provision in the paragraph.
9. Ch. 767, Sec. 3, about 2 inches into the paragraph (modifying LLC Law § 206).
10. Ch. 767, Sec. 3, about 8 inches into the paragraph (modifying LLC Law § 206(a), clause "5-a"). If the top ten change after publication begins, Ch. 767 requires no republication. Therefore, one can simply use "straw men" for formation, replacing them later. One could also use single purpose Delaware entities to hold the ten "most valuable" interests in the entity. If disclosure of ownership information is so crucially important, one would think the Legislature would require it in an LLC's filed charter documents and on the Secretary of State's website. But the requirement applies only to an LLC's published notices, thus producing no disclosure at all in the only places that matter. If publication of the "top ten" is so important, one would think its absence in 49 of 50 states (and in New York for at least 10 years) would have produced horrible problems. The author is aware of none. The Legislature mentioned none. The sponsor's memo simply referred in the abstract to such matters as "add[ing] another dimension to the historical protections afforded consumers in this state."
11. Ch. 767, Sec. 3, about 4 inches into the paragraph (modifying LLC Law § 206(a)). The exempted entities—hedge funds and so on—had apparently threatened to stop doing business in New York. So the Legislature exempted them. *See* New York State Bar Association Business Law Section, Committee on Corporations and Other Business Entities, BLS Corporations #1-A, Memorandum in Opposition to S. 85-A and A. 1075-A, May 11, 2005 (the "BLS Report"), p. 3 (on file with the author). The Business Law Section actively and persuasively opposed Ch. 767 for reasons this column suggests and others. Ch. 767 was not on the RPLS radar screen, because RPLS focuses on legislation specific to real property. The RPLS website offers a "real-time" bill tracker for such legislation—typically dozens or hundreds of bills, most going nowhere. RPLS members can visit the bill tracker at this address: http://www.nysba.org/statewatch/SBA_RPLS.HTM. The utility of the bill tracker is somewhat impaired by the fact that the Legislature's website often doesn't work. If the Legislature cares about public disclosure of important matters, it might fix its website.
12. Ch. 767, Sec. 3, in the last 4 inches of the paragraph (modifying LLC Law § 206). Ch. 767 does not clearly define what it means for an LLC to be suspended. *See* BLS Report, p. 6. Prior law merely prevented an LLC from initiating a lawsuit if it had not properly published its notice. *See* N.Y. LLC Law § 206(a) (before amendment).
13. Ch. 767, Sec. 6 (modifying LLC Law § 1101(s)). The fee to file the mandatory proof of publication was $25. It now rises to $50. The fee continues in New York's proud tradition of charging fees for the privilege of complying with legal requirements to file forms, such as transfer tax returns. (On its own, this extra filing fee is in the same ballpark as the entire LLC formation fee in many states.)
14. The sponsor's memorandum says Ch. 767 was motivated by concern for consumer protection and disclosure, always a good argument for any new legislation—much like preventing fraud, floods, fire hazards, or terrorism. If in fact consumers are suffering (or New York faces increased risks of fraud, floods, fire hazards, or terrorism) because of inadequate disclosure of information about LLCs, Ch. 767 hardly seems an appropriate response to the crisis. Instead, if the Legislature really cares about any of this, it should require more complete (and updated) disclosure in LLC charter documents and on the Secretary of State's website. The BLS Report discusses in greater depth these issues and other possible rationales for Ch. 767. Whatever problem may drive New York's expanded publication requirements, up to 47 of the 50 states do not seem to have recognized any need to solve that problem.
15. S. 6831 (introduced February 28, 2006). A modification and restatement of Ch. 767, this bill was introduced by the same legislator who sponsored Ch. 767, Senator Dean G. Skelos, a nine-term State Senator and Deputy Majority Leader since 1995. *See* http://latfor.state.ny.us/members/?id=2.

16. To check its status, visit this website: http://public.leginfo.state.ny.us/menuf.cgi. Type in this bill number: S6831. If the Legislature's website isn't working, try again in an hour.

17. S. 6831 would eliminate the need to disclose the top ten owners. *See, e.g.,* S. 6831, Sec. 3, about 10 inches into the paragraph (modifying LLC Law § 206(a)). This change also eliminates the need for the Legislature to exempt hedge funds. Except in New York City, S. 6831 would eliminate the requirement to publish LLC notices as if they related to a judicial proceeding.

18. S. 6831 would undo Ch. 767's truncation of the publication period to four weeks, restoring it to six. *See, e.g.,* S. 6831, Sec. 3, about 1 inch into the paragraph (modifying LLC Law § 206(a)).

19. S. 6831, Sec. 4 (proposing to add LLC Law § 609(c)(1)). Other sections of S. 6831 make the same changes for other limited liability entities, their foreign counterparts, and their previously formed counterparts that failed to comply with previous publication requirements. Personal liability for the LLC's debts would replace Ch. 767's suspension of authority to do business, which itself replaced a mere inability to commence a lawsuit.

20. The sponsor's memo for S. 6831 says its goal is "to make . . . information available to the public in a manner, which reinforces the public's right to know the entities with which they are dealing." Under "justification," the sponsor's memo says S. 6831 will clarify publication requirements, "to the benefit of consumers and other persons who do business in this state." That's all. It is hard to see how legal notices strewn through back issues of newspapers can accomplish any of this, particularly when the Secretary of State's website offers the same information in an organized fashion.

21. Those investors will automatically form their "blocker" entities under Delaware law. They won't need to publish in New York because they probably won't do business here. Instead of worsening New York's publication requirements for LLCs, however, New York should improve the New York LLC Law so investors will automatically want to use New York entities, not Delaware ones.

22. The BLS Report estimates New York's publication requirements for limited liability entities yield $40 million a year in newspaper revenues. BLS Report, p. 2. The BLS Report also estimates that New York's filing requirements cost the state $4.5 million a year in filing fees. Presumably that loss reflects only entities that are formed in, e.g., Delaware, but need not qualify in New York. A Delaware entity that wants to do business in New York must still comply with New York's publication requirements, hence cannot avoid publication costs. To avoid those costs, the entire business—jobs, sales tax revenue, rent payments to New York property owners, etc.—must leave New York and move to one of the 47 states that do not require publication.

23. To the extent that RPLS acts as a "guild" for real estate lawyers, we should enthusiastically support Ch. 767 and S. 6831, and suggest improvements. For example, LLCs should file an opinion of counsel to confirm proper publication of notices. This opinion of counsel should be written by hand with a quill pen or on parchment. Such measures would make as much sense as anything already in Ch. 767 or S. 6831.

24. New York should do the opposite: identify what makes Delaware LLCs so attractive, then adopt the corresponding provisions of Delaware's LLC law.

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This column expresses the writer's views. The author believes RPLS leadership and committees share these views, but no one has officially said so. This column also does not necessarily represent the views of any other organization with which the author is affiliated. Anyone who would like to help RPLS respond to New York's LLC legislation or other legislation should communicate with any co-chair of the RPLS Legislation Committee. Contact details appear in the last few pages of this issue of the *Journal*. The author and the *Journal* consent to any republication, reprinting, or further circulation of this column.