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CORPORATE ALERT
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Changes in New York's Publication Requirements for Limited Liability Companies and Limited Partnerships

On June 1, 2006, comprehensive amendments to New York's publication requirements (the "Amended Publication Requirements") will become effective for limited liability companies ("LLCs") and limited partnerships ("LPs"). The Amended Publication Requirements will affect all LLCs (including professional service limited liability companies) and all LPs (including limited liability partnerships) which are "domestic" (*i.e.* formed in New York) or "foreign" (*i.e.* formed in a jurisdiction other than New York and qualified to conduct business in New York).[1] What is perhaps most significant, and most unexpected, is that the Amended Publication Requirements will apply to a substantial number of LLCs and LPs which were formed in or qualified to conduct business in New York *prior* to June 1, 2006. Consequently, as we explain in this memorandum, many of our clients may wish to re-examine prior decisions which they made with respect to compliance with the current New York publication requirements.[2] This memorandum will outline what we consider to be the more significant considerations for our clients which have utilized or plan to utilize LLCs or LPs within the State of New York.[3] ***Pending legislation may effect significant changes in the Amended Publication Requirements. Please note the final section of this memorandum for an outline of possible further changes in New York's publication requirements for LLCs and LPs.***

Expanded Disclosure Requirements. The Amended Publication Requirements will require affected LLCs and LPs to disclose publicly, for the first time, "the names of the ten persons, or such lesser number of persons…who are actively engaged in the business and affairs" of the entity *and* who hold the "most valuable" aggregate rights components of such entity. No guidance is provided as to the scope of "actively engaged", but presumably any manager of an LLC, any general partner of an LP, and any executive officer of either would satisfy this

[1] More limited publication requirements will be imposed on private foundations formed under New York's Not-For-Profit Corporation Law and on private foundation charitable trusts formed under New York's Estates, Powers and Trusts Law.

[2] New York is one of a very small minority of States which requires LLCs and LPs formed or qualified to conduct business in the State to publish notices to such effect over a period of successive weeks. Currently, New York requires successive publications, over a period of six weeks, of information which for the most part is set forth in the documentation filed by the entity with the State and is already available to the public.

[3] This memorandum is provided to our clients as part of Herrick's ongoing general commentary on legal developments, and should not be construed as legal advice for any particular client situation.

requirement.[4] Aggregate rights components are defined, for purposes of LLCs, as "the most valuable membership interests", "including, without limitation: (i) the member's right to a share of the profits and losses of the limited liability company; (ii) the member's right to receive distributions from the limited liability company; and (iii) the member's right to vote and participate in the management of the limited liability company." For purposes of LPs, aggregate rights components are those of "general or limited partners, as the case may be, having the most valuable partnership interests", which are "(i) a partner's share of the profits and losses of a limited partnership, and (ii) a partner's right to receive distributions." For foreign entities, the statutes simply refer to persons holding the "most valuable type of aggregate rights" in such entity as provided in the laws of the entity's jurisdiction of formation. Despite this lack of specificity, it would be expected, in light of the relative uniformity of LLC and LP statutes in the United States, that "foreign" entities formed in the United States would be held to essentially the same aggregate rights tests as New York entities.

The Amended Publication Requirements afford the LLCs and LPs a limited amount of flexibility in selecting the names of persons for disclosure. First, if the ten persons in each of the applicable aggregate rights categories vary in composition, the entity has the flexibility to limit disclosure to ten persons in one of the categories, as selected by the entity, rather than making effectively broader disclosure by publishing the names of the ten persons in each of the categories. Second, if the persons in each of the applicable rights categories number less than ten, the entity may limit disclosure to the persons constituting the greatest number in any of the applicable rights categories. In addition, if there is a change in the required information after the first required publication is made by the entity, the entity will not be obligated to amend the original disclosure publication in compliance with the Amended Publication Requirements. Similarly, if the required information changes after publication has been completed, there is no further obligation imposed upon the entity to amend or republish the disclosures with the changed information.

Exemptions from the Expanded Disclosure Requirements. The expanded disclosure requirements will not apply to entities which are investment advisers, commodity pool operators or commodity trading advisors, or to any "collective investment vehicle" managed by any of the foregoing.[5] The statute does not differentiate between entities which are or are not registered with federal or state securities regulators, so the exemption is broad enough to benefit hedge funds, private equity funds, and their respective managers, as well as registered funds and registered managers.[6]

Changes in Publication Procedures. The Amended Publication Requirements will reduce the publication timeframe from six successive weeks to four successive weeks.[7] On the other hand, the eligible group of publishing sources will be narrowed to newspapers which have been designated at the county level for notices or advertisements of judicial proceedings, one of which must be printed daily and one of which must be printed weekly. There is some degree of

[4] The amendments to New York's Partnership Law suggest that a limited partner may also satisfy this test, depending on the circumstances.

[5] In addition, LLCs operating as theatrical production companies will now enjoy the same complete exemption from publication requirements previously granted to LPs engaged in such business, so long as the name of the entity properly identifies the entity as an LLC.

[6] Collective investment vehicles and their managers would not fare as well under the proposed legislation discussed below.

[7] As before, publication is required within 120 days of formation of a domestic LLC or LP, or within 120 days of the date on which a foreign LLC or LP filed its application for authority to conduct business in New York.

apprehension that in counties where there are a significantly limited number of publishing sources, the narrower eligibility requirements may prompt some enterprising publishers to increase substantially the price of publication. The Amended Publication Requirements will retain the existing requirement of publication in two newspapers of the county in which the office of the entity is intended to be located, but perhaps in consideration of the reduced pool of eligible publishers, publication will no longer be required in at least one newspaper which is published in the city or town where the office of the entity is intended to be located. The Amended Publication Procedures will also generate a new certificate to be filed by the entity, along with the existing affidavits of publication, to confirm compliance. The filing of a certificate of publication will create a presumption of compliance, notwithstanding defects in publication, in the absence of a willful, intentional effort to deceive the public. Filing fees will be doubled from $25 to $50.

Changes in Penalties for Failure to Comply. The Amended Publication Requirements will, at least superficially, increase substantially the penalty for LLCs and LPs which fail to comply. In contrast to the existing statutes, which penalize a non-compliant entity by denying it access to the courts of New York, the penalty under the Amended Publication Requirements will be to suspend the authority of the entity "to carry on, conduct or transact any business" in the State. However, as in the current statutes, the Amended Publication Requirements will provide that such a suspension will not "impair or limit the validity of any contract or act of such" entity, "or any right or remedy of any other party under or by virtue of any [such] contract, act or omission…." In addition, non-complying entities will be permitted, as in the current statutes, to annul the suspension at any time by causing "proof of publication in substantial compliance" (other than with the time period for compliance) to be filed. Therefore, aside from the possible *in terrorem* effect of the new language, it is difficult to envision why the management of an LLC or LP which made a business decision not to comply with the current publication requirements would have any more of an incentive to comply with the new ones; as before, there is no monetary penalty associated with non-compliance, and no express reference to any means by which the penalty might be enforced. However, as before, non-complying entities will experience significant difficulty in obtaining unqualified legal opinions as to due organization and good standing, to the extent required by their transactional activities, and non-complying entities will experience significant difficulties in obtaining judicial relief from New York courts on an emergency basis.

Application of Amended Publication Requirements to Existing Entities. The Amended Publication Requirements will apply to LLCs and LPs which were formed or qualified before June 1, 2006, with three exceptions: (1) LLCs and LPs which complied with the existing publication requirements prior to June 1, 2006 will not be required to republish in compliance with the Amended Publication Requirements; (2) LLCs and LPs formed prior to January 1, 1999 will be deemed to be in compliance with the Amended Publication Requirements, and therefore will be excused from compliance; and (3) LLCs and LPs formed on or after January 1, 1999 will be deemed in compliance with the Amended Publication Requirements if they have filed at least one affidavit of publication under the existing publication rules prior to June 1, 2006; *i.e.* they have satisfied the current publication requirements with respect to one, but not two, newspapers. The Amended Publication Requirements will provide the existing LLCs and LPs to which the requirements apply a compliance grace period of 18 months, ending December 31, 2007.

Further Considerations. The practical impact of the Amended Publication Requirements on existing or newly formed LLCs and LPs may not be known for some time.

Will the Attorney General seek to shut down businesses which do not comply? Will private individuals seek to enforce compliance and in such case will the New York courts entertain such efforts? Will the costs of publication in fact increase?

Businesses which are indifferent to identification of their principal owners or investors may be inclined to resolve these uncertainties by complying with the Amended Publication Requirements. One possible consideration for entities which wish to reconcile compliance with the privacy concerns of their owners is the interposition of foreign LLCs as holding companies for the equity interests of each owner of an LLC or LP subject to the Amended Publication Requirements. The foreign LLCs would take the position that they were not conducting business within the State and therefore not obligated to qualify with the State, or to satisfy the Amended Publication Requirements. Therefore, neither the operating entity nor the foreign LLC holding company entities would identify the beneficial owners of the operating entity. This solution is arguably possible because the expanded disclosure requirements do not expressly require disclosure of the beneficial or indirect owners of the aggregate rights components of the operating entity. However, if such engineering is viewed as a willful, intentional effort to deceive the public, the presumption of compliance achieved when a complying entity files a certificate of publication may be lost. In addition, businesses will need to evaluate the cost of such engineering against the strength of their owners' privacy concerns.

Pending Legislation for Further Change to Publication Requirements. As of the date hereof, similar bills have been introduced in both houses of the New York State legislature, under what is regarded as strong sponsorship, to amend further the publication rules for LLCs and LPs (the "Pending Bills"). The thrust of the Pending Bills is to rescind the Amended Publication Requirements and to reinstate most of the significant provisions in the current statutes, except the penalty for non-compliance.[8] *The Pending Bills would make each member of an LLC and each limited partner of an LP "personally and fully liable, jointly and severally with such [LLC or LP] and with each other [member or limited partner], if any, of such [LLC or LP], for all debts, obligations and liabilities of such [LLC or LP] incurred or arising at any time" from formation through the date on which non-compliance is cured by subsequent publication.*[9]

The imposition of personal liability on the equity holders of LLCs or LPs as a penalty for non-compliance with publication requirements would constitute a drastic departure from the basis upon which LLCs and LPs have been established as desirable investment vehicles. It would also create substantial uncertainty as to liability and as to the satisfaction of claims. Consider, for example, the members of an LLC which is formed on the day after the effective date of the Pending Bills:

- On Day 1, the LLC is formed, raises its capital from investor members A, B and C, and commences operations. The members are shielded from liability for the obligations of the LLC.

[8] The Pending Bills would (i) eliminate the expanded disclosure requirements, (ii) reinstate the six week publication period, (iii) restore the broader pool of newspapers eligible for publication (except in New York City), and (iv) shorten the cure period for pre-existing LLCs and LPs from 18 months to 120 days from the effective date of the Pending Bills.

[9] With regard to pre-existing entities, the period of liability for members or limited partners would run from the effective date of the Pending Bills through the date of subsequent publication and cure.

- On Day 121, the LLC has failed to comply with the applicable publication rules. The members are liable for all obligations of the LLC incurred subsequent to such day or retroactively to Day 1.

- On Day 200, a bank which has extended credit to the LLC sets off the deposit account of member A to satisfy the liability of the LLC.

- On Day 220, the LLC cures its non-compliance by publication. The members are no longer liable for obligations of the LLC incurred subsequent to such day and are retroactively discharged from liabilities of the LLC incurred prior to such day.

- On Day 225, member A sends a demand for reimbursement of the set off deposit to the LLC, a demand for recovery of the set-off deposit to the bank, and a demand for contribution of their pro rata shares of the set-off deposit to members B and C.

Does anyone have an obligation to pay member A?

It should also be noted that the Pending Bills would *not* exempt investors in hedge funds, private equity funds, commodity pools or other types of collective investment vehicles from personal liability for non-compliance by the fund. Assuming that managers of such collective investment vehicles continued to organize or operate in New York after enactment of the Pending Bills, their investors could be expected to demand very firm assurances that the fund had satisfied the applicable publication requirements.

If the Pending Bills are enacted in their present form, we intend to advise our clients to comply promptly with applicable publication requirements.

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We continue to monitor the situation in Albany, and we intend to advise our clients of further developments.

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