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Organization, Operation, and Termination of North Dakota and Minnesota Limited Liability Companies

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**ORGANIZATION, OPERATION, AND TERMINATION OF NORTH
DAKOTA AND MINNESOTA LIMITED LIABILITY
COMPANIES**

MARY B. BADER*

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In the 1990s, a new form of business entity, the limited liability company (LLC), has been added to the smorgasbord of business entity choices.¹ North Dakota’s LLC act became effective on August 1, 1993

1. As of this writing, 46 states have enacted LLC legislation. Set forth below are the states that have LLC legislation, the year the legislation was enacted, and the statutory citation:

Alabama	1993	ALA. CODE §§ 10-12-1 to 10-12-61
Alaska	1994	ALASKA STAT. §§ 10.50.010 to 10.50.995
Arizona	1992	ARIZ. REV. STAT. ANN. §§ 29-601 to 29-857
Arkansas	1993	ARK. CODE ANN. §§ 4-32-101 to 4-32-1316 (Michie)
Colorado	1990	COLO. REV. STAT. §§ 7-80-101 to 7-80-913
Connecticut	1993	1993 CONN. ACTS 267 (Reg. Sess.)
Delaware	1992	DEL. CODE ANN. tit. 6, §§ 18-101 to 18-1107
District of Columbia	1994	D.C. CODE ANN. §§ 29-1301 to 29-1375
Florida	1982	FLA. STAT. ANN. §§ 608.401 to 608.514 (West)
Georgia	1993	GA. CODE ANN. §§ 22-5701 to 22-5799 (Harrison)

and Minnesota's act became effective on January 1, 1993.² This article focuses upon the organization, operation, and dissolution of an LLC under North Dakota and Minnesota law. Before examining the North Dakota and Minnesota LLC acts, however, a brief overview of LLCs is necessary.

I. OVERVIEW OF LLCs

A. LLC TERMINOLOGY

Before discussing the Minnesota and North Dakota LLC acts in detail, it is important to become familiar with LLC terminology. Owners of an LLC are called "members" rather than shareholders or partners.³ A member of an LLC owns a "membership interest," which is akin to shares of stock in a corporation or a partnership interest.⁴ An LLC may have a

Idaho	1993	IDAHO CODE §§ 53-601 to 53-672
Illinois	1992	ILL. ANN. STAT. ch. 805, para. 180/1-1 to 180/1-60 (Smith-Hurd)
Indiana	1993	IND. CODE ANN. §§ 23-18-1-1 to 23-18-13-1 (Burns)
Iowa	1992	IOWA CODE ANN. §§ 490A.100 to 490A.1601 (West)
Kansas	1990	KAN. STAT. ANN. §§ 17-7601 to 17-7652
Kentucky	1994	1994 Ky. Acts 389
Louisiana	1992	LA. REV. STAT. ANN. §§ 12:1301 to 12:1369 (West)
Maine	1994	1994 Me. Legis. Serv. 718 (West)
Maryland	1992	MD. CODE ANN. CORPS. & ASS'NS § 4A-101 to 4A-1103
Michigan	1993	MICH. COMP. LAWS ANN. §§ 450.4101 - 450.5200 (West)
Minnesota	1992	MINN. STAT. ANN. §§ 322B.01 to 322B.960 (West)
Mississippi	1994	1994 Miss. Laws 402
Missouri	1993	MO. ANN. STAT. §§ 347.010 to 347.735 (Vernon)
Montana	1993	MONT. CODE ANN. §§ 35-8-1201 to 35-8-1307
Nebraska	1993	NEB. REV. STAT. §§ 21-2601 to 21-2645
Nevada	1991	NEV. REV. STAT. ANN. Title 86 (Michie)
New Hampshire	1993	N.H. REV. STAT. ANN. §§ 304-C:1 to 304-C:85
New Jersey	1993	N.J. STAT. ANN. §§ 42:2B-1 to 42:2B-69 (West)
New Mexico	1993	N.M. STAT. ANN. §§ 53-19-1 to 53-19-74 (Michie)
New York	1994	1994 N.Y. Laws 576
North Carolina	1993	N.C. GEN. STAT. §§ 57C-1-01 to 57C-10-07
North Dakota	1993	N.D. CENT. CODE §§ 10-32-01 to 10-32-155
Ohio	1994	1994 Ohio Laws 103
Oklahoma	1992	OKLA. STAT. ANN. tit. 18, §§ 2000 to 2060 (West)
Oregon	1993	OR. REV. STAT. §§ 63.001 to 63.990
Rhode Island	1992	R.I. GEN. LAWS §§ 7-16-1 to 7-16-75
South Carolina	1994	S.C. CODE ANN. §§ 33-43-101 to 33-43-1409
South Dakota	1993	S.D. CODIFIED LAWS ANN. §§ 47-34-1 to 47-34-59
Tennessee	1994	1994 Tenn. Pub. Acts 868
Texas	1991	TEX. REV. CIV. STAT. ANN. art. 1528n (West)
Utah	1991	UTAH CODE ANN. §§ 48-2b-101 to 48-2b-157
Virginia	1991	VA. CODE ANN. §§ 13.1-1000 to 13.1-1123 (Michie)
West Virginia	1992	W. VA. CODE §§ 31-1A-1 to 31-1A-69
Washington	1994	1994 Wash. Legis. Serv. 211 (West)
Wisconsin	1993	WIS. STAT. §§ 183.0102 to 183.1305
Wyoming	1977	WYO. STAT. §§ 17-15-101 to 17-15-143

The remaining states have LLC legislation pending.

2. N.D. Const. art. IV, § 13 (Supp. 1993) (providing effective dates for new laws); 1992 Minn. Laws ch. 517, art. 2, § 142 (providing effective dates for new laws).

3. Carter G. Bishop & Daniel S. Kleimberger, *Beyond Subchapter S: The New Limited Liability Company*, BENCH & BAR OF MINNESOTA, July 1992, 18, 20.

4. *Id.*

board of governors, which functions in a similar capacity to a board of directors of a corporation.⁵ Finally, an LLC has "managers" (rather than officers of a corporation), who manage the day-to-day affairs of the LLC.⁶

B. THE NEED FOR LLCs

Many business owners are interested in having limited liability, but avoiding double taxation. Historically, these entrepreneurs had two entity choices: limited partnerships or S corporations. Limited partnerships and S corporations do provide their owners with limited liability and a single layer of taxation; however, they also have drawbacks. In a limited partnership, at least one partner (the general partner) has personal liability for entity debts. Moreover, if a limited partner participates in the management of the limited partnership, he or she can be personally liable for partnership debts.⁷ An S corporation has a set of inflexible rules which can be cumbersome for business owners. For example, an S corporation can only have up to thirty-five shareholders;⁸ there are limits on who can be an S corporation shareholder;⁹ an S corporation cannot be a member of an affiliated group;¹⁰ and an S corporation can have only one class of stock.¹¹ Moreover, in certain instances, an S corporation may be taxed like a C corporation.¹²

LLCs allow business owners to avoid some of the problems associated with limited partnerships and S corporations. LLCs provide their members with limited liability regardless of the members' participation in management.¹³ In addition, if an LLC has certain characteristics, it will be taxed under the flexible partnership rules, rather than the inflexible S corporation rules.

5. *Id.*

6. *Id.*

7. N.D. CENT. CODE § 45-10.1-22(1) (1993); MINN. STAT. ANN. § 322A.26(a) (West Supp. 1994).

8. I.R.C. § 1361(b)(1)(A) (West 1988 & Supp. 1993).

9. Only individuals, estates and certain trusts can be shareholders of an S corporation. I.R.C. § 1361(b)(1)(B) (West 1988 & Supp. 1993). Moreover, an S corporation cannot have a nonresident alien as a shareholder. I.R.C. § 1361(b)(1)(C) (West 1988 & Supp. 1993).

10. I.R.C. § 1361(b)(2)(A) (West 1988 & Supp. 1993).

11. I.R.C. § 1361(b)(1)(D) (West 1988 & Supp. 1993). Currently, the S Corporation Reform Act of 1993 is pending in Congress, which would change some of these inflexible rules. This bill would increase the number of permitted shareholders to 50, broaden the types of permitted shareholders, and liberalize the rules regarding one class of stock. See S. 1690, 103d Cong., 1st Sess. §§ 101-202 (1993).

12. See, e.g., I.R.C. §§ 1371(a)(1) (West 1988), 311(b) (West 1988 & Supp. 1993) (providing that an S corporation's distribution of appreciated property to its shareholders triggers gain to the corporation, which is passed through to the shareholders).

13. N.D. CENT. CODE § 10-32-29 (Supp. 1993); MINN. STAT. ANN. § 322B.303 (West Supp. 1994).

C. CHARACTERISTICS NECESSARY FOR PARTNERSHIP TAXATION

To be classified as a partnership for federal income tax purposes, an LLC must lack two of the following four corporate characteristics: (1) continuity of life; (2) centralized management; (3) limited liability; and (4) free transferability of interests.¹⁴ Each of these characteristics is discussed below.

1. *Continuity of Life*

Treasury Department regulations provide that an organization does not have continuity of life if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause a dissolution of the entity.¹⁵ Furthermore, continuity of life will not exist in a limited partnership, even if a majority in interest of the remaining partners agree to continue the partnership after the occurrence of an event of dissolution.¹⁶

2. *Centralized Management*

Treasury Department regulations provide that “[a]n organization has centralized management if any person [or persons] has continuing exclusive authority to make the management decisions necessary to the conduct of the business”¹⁷ The person who has such authority may or may not be a member of the organization and may hold office as a result of a selection by the members.¹⁸

3. *Limited Liability*

Treasury Department regulations provide that an organization has limited liability if, under local law, there is no member who is personally liable for the debts of the organization.¹⁹ Personal liability means that a creditor of an organization may seek personal satisfaction from a member if “the assets of the organization are insufficient to satisfy the creditor’s claim.”²⁰

4. *Free Transferability of Interests*

Treasury Department regulations provide that an organization has free transferability of interests if those members owning substantially all of the interests in the organization have the power (without the consent of

14. See Treas. Reg. § 301.7701-2(a)(3) (1993); Rev. Rul. 88-76, 1988-2 C.B. 360.

15. Treas. Reg. § 301.7701-2(b)(1) (1993).

16. Treas. Reg. § 301.7701-2(b)(1) (1993) (as amended by T.D. 8475, 1993-1 C.B. 236).

17. Treas. Reg. § 301.7701-2(c)(1) (1993).

18. Treas. Reg. § 301.7701-2(c)(2) (1993).

19. Treas. Reg. § 301.7701-2(d)(1) (1993).

20. *Id.*

the other members) to substitute a person (who is not a member) as a member of the organization.²¹ In order for free transferability to exist, the member must be able to confer all the attributes of ownership in the organization upon the substitute.²²

In North Dakota and Minnesota, an LLC has the corporate characteristic of limited liability.²³ Therefore, to be taxed as a partnership, an LLC must lack two of the three remaining corporate characteristics. The Internal Revenue Service has privately ruled that a Minnesota LLC and a North Dakota LLC were each taxable as partnerships because they both lacked the corporate characteristics of continuity of life and free transferability of interests.²⁴

D. BUSINESSES USING LLCs

LLCs have generated a tremendous amount of interest nationwide.²⁵ Although LLCs have widespread appeal, they are particularly useful in certain areas of business.

1. *Professionals*

LLCs are attractive to professionals because they offer limited liability to all members, regardless of the members' participation in management. Thus, a member of an LLC generally has no personal liability for the malpractice of other members. As is true in a partnership or corporation, however, an LLC member continues to be personally liable for his or her own malpractice.²⁶ With more and more malpractice actions being commenced against professionals, the LLC has become a popular entity choice.

One issue that has recently been resolved regarding professional LLCs is whether the cash method of accounting²⁷ can be used. Professionals prefer to use the cash method of accounting, rather than the accrual method,²⁸ because they do not want to recognize income from

21. Treas. Reg. § 301.7701-2(e)(1) (1993).

22. *Id.*

23. N.D. CENT. CODE § 10-32-29(1) (Supp. 1993); MINN. STAT. ANN. § 322B.303, subd. 1 (West Supp. 1994).

24. Priv. Ltr. Rul. 93-50-013 (Sept. 15, 1993); Priv. Ltr. Rul. 94-25-013 (March 23, 1994).

25. See *supra* note 1 and accompanying text.

26. Compare N.D. CENT. CODE § 10-31-09 (Supp. 1993) (limiting the personal liability of a shareholder in a professional corporation only to his or her personal malpractice) with N.D. CENT. CODE § 10-32-29(2) (Supp. 1993) (limiting the personal liability of an LLC member only to his or her personal malpractice).

27. Under the cash method of accounting, income is reported in the year it is actually or constructively received. Expenditures are generally deducted in the year in which amounts are actually paid. See Treas. Reg. § 1.446-1(c)(1)(i) (1993).

28. Under the accrual method of accounting, income is reported when all events have occurred that fix the right to receive income. Deductions are generally taken in the year in which all events have occurred that establish the existence of the liability. See Treas. Reg. § 1.446-1(c)(1)(ii) (1993).

their accounts receivable until such amounts have actually been collected. The Internal Revenue Service has privately ruled that the cash method of accounting is available to professional LLCs if the members actively participate in the management of the business.²⁹

In the late 1980s and early 1990s, professionals found LLCs appealing because of their unique ability to combine limited liability for all members with the flexibility of partnership taxation. Moreover, at that time, maximum individual tax rates were lower than maximum corporate tax rates.³⁰ In 1993, however, Congress raised maximum individual tax rates.³¹ The maximum individual tax rates are now higher than the maximum corporate tax rates.³² In view of that fact, it remains to be seen whether the trend for professionals to use LLCs will continue.

2. Real Estate Industry

The real estate industry is also finding LLCs to be particularly useful. Before the advent of LLCs, real estate ventures were typically organized as either general or limited partnerships. The advantage of a general partnership is that all owners may participate in management. The advantage of a limited partnership is that all limited partners have limited liability for partnership debts. An LLC combines the advantages of both. In an LLC, all members can participate in management and still have limited liability.³³

Low income housing projects that historically have operated as general partnerships are now organizing as or converting to LLCs. The flexible partnership tax rules coupled with limited liability offer the real estate industry a powerful new business planning tool.

E. RESTRICTIONS ON USING THE LLC FORM

Just as certain types of businesses are finding LLCs advantageous, other types of businesses may be restricted or prohibited by state statute from operating in the LLC form. In Minnesota, an LLC may not engage

29. Priv. Ltr. Rul. 93-21-047 (May 28, 1993); Priv. Ltr. Rul. 93-28-005 (July 16, 1993); Priv. Ltr. Rul. 93-50-013 (Sept. 15, 1993).

30. Compare I.R.C. § 1 (1987) (codifying the Tax Reform Act of 1986, Pub. L. No. 99-514 § 101(a), 100 Stat. 2096 (lowering maximum individual tax rates to 28%)) with I.R.C. § 11 (1987) (codifying the Tax Reform Act of 1986, Pub. L. No. 99-514 § 601(b), 100 Stat. 2249 (establishing maximum corporate tax rates at 34%)). See also Revenue Reconciliation Act of 1990, Pub. L. No. 101-508 § 11101(a), 104 Stat. 1388-403 to 404 (raising maximum individual tax rates to 31% but leaving existing corporate tax rates unchanged).

31. See Pub. L. No. 103-66 § 13203(b), 107 Stat. 461, 461 (1993) (increasing individual tax rates); Pub. L. No. 103-66 § 1322(a), 107 Stat. 477 (1993) (increasing corporate tax rates).

32. Compare I.R.C. § 1 (1994) (establishing maximum individual tax rates at 39.6%) with I.R.C. § 11 (1994) (establishing maximum corporate tax rates at 35%).

33. See *supra* note 13.

in farming.³⁴ In North Dakota, an LLC may engage in farming only if it meets the corporate farming requirements.³⁵ State securities laws also restrict the use of LLCs. Unless all members have substantial rights in the management of the business (i.e. decentralized management), an LLC membership interest will probably be deemed to be a security.³⁶

F. CONVERSION OF EXISTING ENTITIES

Many business owners are contemplating converting existing businesses to LLCs. Before advising existing entities to convert to LLCs, the tax consequences of such a conversion must be carefully considered.

1. Conversion of Corporations

For federal income tax purposes, a conversion of a C corporation to an LLC is treated as a liquidation of the C corporation followed by a contribution of the assets by the owners to a partnership.³⁷ Thus, if the corporation has appreciated assets, a conversion to an LLC results in two layers of tax: (1) a corporate-level tax, and (2) a shareholder-level tax.³⁸

The conversion of an S corporation to an LLC is also treated as a liquidation/contribution.³⁹ Once again, if the corporation owns appreciated assets, it recognizes a gain.⁴⁰ Since the corporation is an S corporation, however, the gain passes through to the shareholders and increases their bases.⁴¹ As a result, in most instances, there is only a single level of tax on the conversion of an S corporation.⁴²

2. Conversion of Partnerships

A conversion of a general or limited partnership to an LLC is generally a nontaxable event to the entity and its partners.⁴³ Assuming no change in ownership, such a conversion is not deemed to be a termination of the partnership.⁴⁴ Therefore, it appears that a converted LLC retains all of the elections of the old partnership, including its accounting meth-

34. MINN. STAT. ANN. § 500.24, subd. 3 (West Supp. 1994).

35. See N.D. CENT. CODE § 10-06.1-02 (Supp. 1993) (providing the requirements necessary to engage in corporate farming).

36. Bishop & Kleinberger, *supra* note 3, at 22.

37. *Id.* at 21.

38. I.R.C. § 336 (West 1988 & Supp. 1993); I.R.C. § 331 (West 1988).

39. Bishop & Kleinberger, *supra* note 3, at 21.

40. I.R.C. § 1371(a)(1) (West 1988); I.R.C. § 336 (West 1988 & Supp. 1993).

41. I.R.C. § 1367(a)(1) (West 1988).

42. *But see, e.g.*, I.R.C. § 1374 (West Supp. 1993) (providing for a tax on built-in gains).

43. I.R.C. § 721 (West 1988). See also Rev. Rul. 84-52, 1984-1 C.B. 157 (discussing the conversion of a general partnership to a limited partnership); Priv. Ltr. Rul. 92-10-019 (Dec. 6, 1991), 91-19-029 (Feb. 7, 1991) (discussing the conversion of a limited partnership to an LLC); Priv. Ltr. Rul. 90-29-019 (April 19, 1990), 92-26-035 (June 26, 1992), 93-21-047 (May 28, 1993) (discussing the conversion of a general partnership to an LLC).

44. I.R.C. § 708 (West 1988); Treas. Reg. § 1.708-1(b)(ii) (1993).

ods, depreciation methods, fiscal year election, and the election to adjust its asset bases under section 754 of the Internal Revenue Code.

In some partnership conversions, there may be a liability shift among the partners. This liability shift could cause gain to be recognized by some partners. For example, a conversion of a limited partnership to an LLC may treat general partners as having received a distribution to the extent that they are released from their liability on partnership debt.⁴⁵ If the amount of the liability shift exceeds a partner's basis in his or her partnership interest, the excess of the debt relief over basis is taxed as gain.⁴⁶

II. ORGANIZATION OF NORTH DAKOTA AND MINNESOTA LLCs

As the discussion in the previous section indicates, LLCs offer business owners the unique opportunity to combine the flexible partnership tax rules with limited liability for all members. For this reason, North Dakota and Minnesota business owners may be eager to organize LLCs. However, LLCs are similar to corporations in that their creation, operation, and termination are governed exclusively under state law. Therefore, a closer look at the statutes of each state is necessary.

The Minnesota LLC act is based upon a partnership model that has been modified to adopt corporate default management and governance rules.⁴⁷ The North Dakota LLC act employs a similar approach because it is patterned after the Minnesota LLC act. Minnesota and North Dakota LLCs have financial and dissolution structures that are similar to partnerships.⁴⁸ Unless otherwise agreed by the members, however, both Minnesota and North Dakota LLCs have corporate governance and management structures.⁴⁹ This hybrid approach makes Minnesota and North Dakota LLCs eligible for partnership tax treatment and at the same time, makes LLCs accessible to business owners who lack the resources to pay for specially tailored agreements.⁵⁰ While there are obvious similarities between the Minnesota and North Dakota LLC acts, there are also some current differences. The similarities and the differences are discussed below.

45. I.R.C. §§ 752(b), 731(a)(1) (West 1988).

46. I.R.C. § 731(a)(1) (West 1988).

47. Bishop & Kleinberger, *supra* note 3, at 20.

48. *Id.* at 20-21.

49. *Id.* at 20.

50. *Id.*

A. ARTICLES OF ORGANIZATION

1. *Mandatory Provisions*

In Minnesota and North Dakota, an LLC is established by filing articles of organization with the secretary of state.⁵¹ The articles of organization of an LLC are analogous, but not identical, to articles of incorporation of a corporation. As with a corporation, the articles of organization of a Minnesota and North Dakota LLC must contain the name of the entity.⁵² The LLC's name must contain the words "limited liability company" or "professional limited liability company" or the abbreviation of either term.⁵³ As with a corporation, the articles of organization of an LLC must also contain: (1) the address of the registered office,⁵⁴ (2) the name of the registered agent of the LLC,⁵⁵ and (3) the name and address of each organizer.⁵⁶

In both Minnesota and North Dakota, the articles of organization of an LLC are different than those of a corporation in that they must specifically state: (1) the limited period of existence for the LLC, which must be thirty years or less in North Dakota but may be a longer period in Minnesota;⁵⁷ (2) whether upon the occurrence of a dissolution event, the remaining members will have the power to avoid dissolution by giving dissolution avoidance consent;⁵⁸ and (3) whether the members have the

51. N.D. CENT. CODE § 10-32-05 (Supp. 1993); MINN. STAT. ANN. § 322B.105 (West Supp. 1994). In North Dakota, the legal life of an LLC begins when the secretary of state issues a certificate of organization. N.D. CENT. CODE § 10-32-09 (Supp. 1993). In Minnesota, the legal life of an LLC begins when the articles of organization are filed with the secretary of state and the proper fee has been paid. MINN. STAT. ANN. § 322B.175 (West Supp. 1994).

52. N.D. CENT. CODE § 10-32-07(1)(a) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 1(1) (West Supp. 1994).

53. N.D. CENT. CODE § 10-32-10(1)(b) (Supp. 1993); MINN. STAT. ANN. § 322B.12, subd. 1(2) (West Supp. 1994).

54. N.D. CENT. CODE § 10-32-07(1)(c) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 1(2) (West Supp. 1994). In addition, North Dakota requires the LLC to provide the address of its principal executive office. N.D. CENT. CODE § 10-32-07(1)(b) (Supp. 1993).

55. N.D. CENT. CODE § 10-32-07(1)(c) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 1(2) (West Supp. 1994).

56. N.D. CENT. CODE § 10-32-07(1)(d) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 1(3) (West Supp. 1994).

57. N.D. CENT. CODE § 10-32-07(1)(e) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 1(4) (West Supp. 1994). In 1993, Minnesota amended its LLC act to allow a period of existence in excess of 30 years if the articles of organization expressly authorize a longer period of duration. 1993 Minn. Laws ch. 137 § 23 (appearing to rely on Priv. Ltr. Rul. 93-31-010 (May 5, 1993)). In Private Letter Ruling 93-31-010, the Internal Revenue Service ruled that an LLC lacked continuity of life even though its articles of organization stated a maximum duration of 75 years. See Priv. Ltr. Rul. 93-31-010 (May 5, 1993). Hence, it seems that extending the maximum period of duration from 30 to 75 years will not jeopardize an LLC's partnership tax status. As a result, it appears that the North Dakota legislature should follow the lead of the Minnesota legislature and extend the period of duration for North Dakota LLCs. Assuming an event of dissolution does not end the legal life of an LLC sooner, such an amendment would mean that a North Dakota LLC would only have to reorganize once every 75 years instead of once every 30 years.

58. N.D. CENT. CODE § 10-32-07(1)(f) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 1(5) (West Supp. 1994).

power to enter into a business continuation agreement.⁵⁹ These statutory requirements address the partnership tax requirement that the LLC must lack continuity of life.

2. *Optional Provisions*

The Minnesota and North Dakota LLC acts allow LLCs to opt out of all or a portion of the corporate governance and management structure. However, all members must so agree.⁶⁰ For example, all members of a Minnesota or North Dakota LLC may agree: (1) that the LLC will not have an operating agreement;⁶¹ (2) that no LLC member will have cumulative voting rights;⁶² or (3) that no LLC member will have preemptive rights to make additional contributions.⁶³ These optional provisions may be set forth in the articles of organization or in a member control agreement.⁶⁴ Certain other optional provisions may also be agreed to in the operating agreement.⁶⁵ The operating agreement and member control agreement are discussed in the next section.

B. LLC GOVERNANCE MODELS

Organizers of a Minnesota or North Dakota LLC may choose to operate using a corporate model of governance, a partnership model of governance, or a combination of both. Generally, a corporate model is an advantageous governance model when the members want a centralized management system and are using a simple financial arrangement. On the other hand, a partnership model of governance is generally advantageous when the members want decentralized management or wish to use special allocations of income, gain, loss, or deductions.

59. N.D. CENT. CODE § 10-32-07(1)(g) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 1(6) (West Supp. 1994).

60. See N.D. CENT. CODE §§ 10-32-07(2) to (6) and 10-32-50(1) to (2) (Supp. 1993); MINN. STAT. ANN. §§ 322B.115, subds. 2-6 and 322B.37, subds. 1-2 (West Supp. 1994).

61. N.D. CENT. CODE § 10-32-07(2)(c) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 2(3) (West Supp. 1994).

62. N.D. CENT. CODE § 10-32-07(2)(d) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 2(4) (West Supp. 1994).

63. N.D. CENT. CODE §§ 10-32-07(2)(k), 10-32-37 (Supp. 1993); MINN. STAT. ANN. §§ 322B.115, subd. 2(11); 322B.33 (West Supp. 1994).

64. N.D. CENT. CODE §§ 10-32-07(2) to (6), 10-32-50(1) to (2) (Supp. 1993); MINN. STAT. ANN. §§ 322B.115, subd. 2(6); 322B.37 subd. 1(2) (West Supp. 1994).

65. N.D. CENT. CODE § 10-32-07(3) to (4) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subds. 3-4 (West Supp. 1994). Optional provisions may include: (1) term that governors serve; (2) compensation of governors; (3) removal of governors; (4) replacement of governors; (5) place for meetings of governors; (6) who may call a meeting of governors; (7) quorum for meetings of governors; (8) committee of governors; (9) creation of special litigation committee; (10) duties of managers; (11) delegation of duties by managers; (12) regular meetings of members; (13) notice for member meetings; (14) quorum at meetings of members; (15) members entitled to vote; (16) indemnification of governors and managers; (17) authorization of distributions; and (18) right to interim distributions. N.D. CENT. CODE § 10-32-07(3) (Supp. 1993); MINN. STAT. ANN. § 322B.115, subd. 3 (West Supp. 1994).

1. *Corporate Model of Governance*

If a corporate governance model is used, the LLC organizational documents are analogous to corporate organizational documents. In addition to the articles of organization, an LLC using the corporate model of governance will most likely have minutes from the organizational meeting or written action in lieu of such a meeting, an operating agreement, and a member control agreement.

a. Organizational meeting

Once the life of the LLC has legally commenced, the organizers must have an organizational meeting or take written action in lieu of an organizational meeting.⁶⁶ This requirement tracks the Minnesota and North Dakota corporate statutes closely.⁶⁷ At the organizational meeting, either the organizers or the governors⁶⁸ take the usual organizational actions. For example, the following actions are typically taken at the organizational meeting: (1) adopting an operating agreement; (2) electing governors unless they have already been named; (3) electing managers; (4) adopting banking resolutions; (5) contracting to accept and receive contributions; (6) adopting a fiscal year; and (7) making any appropriate tax elections.⁶⁹

b. Operating agreement

An operating agreement is defined as rules, resolutions, or other provisions that relate to the management of the business or the regulation of the affairs of the LLC.⁷⁰ The operating agreement is analogous to the bylaws of a corporation.⁷¹ Typical provisions found in a Minnesota or North Dakota LLC operating agreement govern: (1) meetings and voting of members;⁷² (2) number, qualifications, and compensation of governors;⁷³ (3) number, duties, and salaries of managers;⁷⁴ (4) indemnification

66. N.D. CENT. CODE § 10-32-67(2) (Supp. 1993); MINN. STAT. ANN. § 322B.60, subd. 2 (West Supp. 1994).

67. See N.D. CENT. CODE § 10-19.1-30 (1985); MINN. STAT. ANN. § 302A.171, subd. 2 (West 1985 & Supp. 1994).

68. The persons who are to serve as the first board of governors may be named in the articles of organization or the member control agreement. N.D. CENT. CODE §§ 10-32-07(4), 10-32-50(2) (Supp. 1993). MINN. STAT. ANN. §§ 322B.115, subd. 4(1); 322B.37, subd. 2 (West Supp. 1994).

69. N.D. CENT. CODE § 10-32-67(2) (Supp. 1993); MINN. STAT. ANN. § 322B.60, subd. 2 (West Supp. 1994).

70. N.D. CENT. CODE §§ 10-32-02(31), 10-32-68(1) (Supp. 1993); MINN. STAT. ANN. §§ 322B.03, subd. 33; 322B.603, subd. 1 (West Supp. 1994).

71. MINN. STAT. ANN. § 322B.603 cmt. (West Supp. 1994).

72. N.D. CENT. CODE §§ 10-32-38 to -48 (Supp. 1993); MINN. STAT. ANN. §§ 322B.333 to .363 (West Supp. 1994).

73. N.D. CENT. CODE §§ 10-32-69 to -87 (Supp. 1993); MINN. STAT. ANN. §§ 322B.606 to .666 (West Supp. 1994).

74. N.D. CENT. CODE §§ 10-32-88 to -96 (Supp. 1993); MINN. STAT. ANN. §§ 322B.67 to .69 (West Supp. 1994).

of governors and managers;⁷⁵ and (5) amendment of the operating agreement.⁷⁶

When the corporate form of governance is adopted, the operating agreement does not usually set forth the financial structure of the LLC. Instead, the financial provisions are usually set forth in the member control agreement.

c. Member control agreement

A member control agreement is analogous to a corporate shareholder agreement.⁷⁷ To be valid in Minnesota and North Dakota, a member control agreement must initially be in writing and signed by all persons who are members of the LLC.⁷⁸ Note, however, that no provision in either North Dakota or Minnesota law requires that subsequent amendments to a member control agreement must be agreed to by all members. As a result, it appears that once a member control agreement has been agreed to by all members, it may subsequently be amended by a majority in interest of all existing members.

A member control agreement is binding upon and enforceable against all members who are parties to it.⁷⁹ It is also binding upon and enforceable against all other persons who have knowledge of the existence of the agreement.⁸⁰ By statute, member control agreements are specifically enforceable.⁸¹ The LLC must note in its required records⁸² that its

75. N.D. CENT. CODE § 10-32-99 (Supp. 1993); MINN. STAT. ANN. § 322B.699 (West Supp. 1994).

76. N.D. CENT. CODE § 10-32-68(2) - (3) (Supp. 1993); MINN. STAT. ANN. § 322B.603, subs. 2-3 (West Supp. 1994).

77. Bishop & Kleinberger, *supra* note 3, at 20.

78. N.D. CENT. CODE § 10-32-50(2) (Supp. 1993); MINN. STAT. ANN. § 322B.37, subd. 2 (West Supp. 1994).

79. N.D. CENT. CODE § 10-32-50(3) (Supp. 1993); MINN. STAT. ANN. § 322B.37, subd. 3 (West Supp. 1994).

80. Transferees of the membership interest or creditors of the LLC are bound if they have actual knowledge of the member control agreement. N.D. CENT. CODE § 10-32-50(3) (Supp. 1993); MINN. STAT. ANN. § 322B.37, subd. 3 (West Supp. 1994).

81. N.D. CENT. CODE § 10-32-50(4) (Supp. 1993); MINN. STAT. ANN. § 322B.37, subd. 3(b) (West Supp. 1994). See *infra* notes 192-194 and accompanying text for discussion of an agreement to give dissolution avoidance consent, which is not specifically enforceable in Minnesota. North Dakota's LLC Act does not contain a comparable provision.

82. Required records include: (1) current information about each member, governor and manager; (2) current information about each assignee of financial rights and a description of the rights assigned; (3) copy of the articles of organization and any amendments thereto; (4) copies of the current operating agreement; (5) copies of the LLC's federal, state, and local income tax returns and reports for the three most current years; (6) annual financial statements; (7) records of all meetings of members; (8) records of all meetings of governors; (9) reports made to members within the last three years; (10) member control agreements; (11) statement of all contributions accepted by the LLC; (12) statement of all contribution agreements entered into by would-be contributors; (13) statement of all contribution allowance agreements entered into by would-be contributors; (14) explanation of any restatement of value of a previous contribution; (15) any written consents obtained from members; and (16) a copy of agreements or contracts relating to membership interests. N.D. CENT. CODE § 10-32-51(1) (Supp. 1993); MINN. STAT. ANN. § 322B.373, subd. 1 (West Supp. 1994).

members' interests are governed by a member control agreement.⁸³ In addition, a copy of the member control agreement must be filed with the LLC.⁸⁴ A member of an LLC may obtain a copy of the member control agreement from the LLC upon making a written demand.⁸⁵

When the corporate governance model is used, the operating agreement contains the management and governance provisions of the LLC. The member control agreement sets forth provisions dealing with the financial structure of the LLC and the rights and obligations of individual members of the LLC. For example, when a corporate governance model is used, the member control agreement will typically set forth the financial structure of the LLC including: (1) allocation of income and loss to the members;⁸⁶ (2) operating distribution to members;⁸⁷ and (3) tax provisions such as maintenance of capital accounts,⁸⁸ liquidating distributions,⁸⁹ negative capital accounts and qualified income offsets,⁹⁰ and nonrecourse deductions.⁹¹

In addition to the financial provisions, the member control agreement enumerates the rights and obligations of the members such as: (1) voting rights;⁹² (2) dissenters' rights or the waiver of such rights;⁹³ (3) obligations to make additional capital contributions, if any;⁹⁴ (4) the power of each member to give dissolution avoidance consent;⁹⁵ and (5) the power of each member to enter into a business continuation agreement.⁹⁶

83. N.D. CENT. CODE § 10-32-50(3) (Supp. 1993); MINN. STAT. ANN. § 322B.37, subd. 3 (West Supp. 1994).

84. N.D. CENT. CODE § 10-32-50(3) (Supp. 1993); MINN. STAT. ANN. § 322B.37, subd. 3 (West Supp. 1994). An LLC must keep a copy of all required records (including the member control agreement) at its principal executive office. N.D. CENT. CODE § 10-32-51(1) (Supp. 1993); MINN. STAT. ANN. § 322B.373, subd. 1 (West Supp. 1994).

85. N.D. CENT. CODE § 10-32-51(1) (Supp. 1993); MINN. STAT. ANN. § 322B.373, subd. 1 (West Supp. 1994).

86. N.D. CENT. CODE §§ 10-32-36, 10-32-07(2) (Supp. 1993); MINN. STAT. ANN. §§ 322B.326, 322B.115, subd. 2(15) (West Supp. 1994).

87. N.D. CENT. CODE §§ 10-32-60, 10-32-07(2)(n) (Supp. 1993); MINN. STAT. ANN. §§ 322B.50, 322B.115, subd. 2(14) (West Supp. 1994).

88. Treas. Reg. § 1.704-1(b)(2)(iv) (1993).

89. Treas. Reg. § 1.704-1(b)(2)(ii)(b)(3) (1993).

90. *Id.*; Treas. Reg. § 1.704-1(b)(2)(ii)(d)(3) (1993).

91. Treas. Reg. § 1.704-2(b) (1993).

92. N.D. CENT. CODE §§ 10-32-45(2), 10-32-07(2)(m) (Supp. 1993); MINN. STAT. ANN. §§ 322B.356, subd. 2; 322B.115, subd. 2(13) (West Supp. 1994).

93. N.D. CENT. CODE §§ 10-32-54 to -55, 10-32-50(5) (Supp. 1993); MINN. STAT. ANN. §§ 322B.363 - 322B.386, 322B.37, subd. 3(c) (West Supp. 1994).

94. N.D. CENT. CODE §§ 10-32-58, 10-32-07(2)(g) (Supp. 1993); MINN. STAT. ANN. §§ 322B.42, 322B.115, subd. 2(7) (West Supp. 1994).

95. N.D. CENT. CODE §§ 10-32-109(e), 10-32-07(1)(f) (Supp. 1993); MINN. STAT. ANN. §§ 322B.115, subd. 1(5); 322B.80, subd. 1(5) (West Supp. 1994).

96. N.D. CENT. CODE §§ 10-32-07(1)(g), 10-32-50(1) (Supp. 1993); MINN. STAT. ANN. §§ 322B.115, subd. 1(6); 322.37, subd. 1 (West Supp. 1994).

Under both Minnesota and North Dakota statutes, member control agreements may not include an agreement to give transfer consent.⁹⁷ An agreement to give transfer consent is a member control agreement in which a member agrees, in advance, to consent to the assignment of governance rights of another member.⁹⁸ The reason for this statutory restriction is to ensure that Minnesota and North Dakota LLCs lack the corporate characteristic of free transferability of interest.⁹⁹

A corporate model of governance provides the same centralized management structure as a corporation. An LLC using the corporate model of governance, therefore, has two of the four corporate characteristics: limited liability and centralized management. To obtain partnership tax treatment, it is imperative that an LLC using the corporate governance model lack the remaining two corporate characteristics: continuity of life and free transferability of interests.¹⁰⁰

2. *Partnership Model of Governance*

If a partnership governance model is used, the LLC organizational documents are analogous to those of a limited partnership. An LLC using the partnership governance model has, at a minimum, articles of organization and a member control agreement. An operating agreement may or may not be used, depending upon whether the entity opts to have centralized management.

a. Organizational meeting

When the partnership model of governance is used by an LLC, the organizers generally are not required to have an organizational meeting or take written action in lieu of such a meeting. This approach follows general partnership law under which such formalities are unnecessary.¹⁰¹

b. Operating agreement

By statute, an LLC may, but need not, have an operating agreement.¹⁰² In a partnership governance model, if the LLC members are generally passive investors, the LLC functions like a limited partnership. An operating agreement (which sets forth a centralized management and

97. N.D. CENT. CODE § 10-32-50(1)(c) (Supp. 1993); MINN. STAT. ANN. § 322B.37, subd. 1 (West Supp. 1994).

98. N.D. CENT. CODE § 10-32-02(3) (Supp. 1993); MINN. STAT. ANN. § 322B.03, subd. 5 (West Supp. 1994).

99. See *supra* notes 21-22 and accompanying text.

100. See *supra* note 14 and accompanying text.

101. No comparable requirement exists in either the Uniform Partnership Act or the Revised Uniform Limited Partnership Act.

102. N.D. CENT. CODE § 10-32-68(1) (Supp. 1993); MINN. STAT. ANN. § 322B.603, subd. 1 (West Supp. 1994).

governance structure) may be desirable in that situation for passive investors.¹⁰³ On the other hand, if the LLC members want to actively participate in the management of the LLC, the LLC operates like a general partnership. Hence, an operating agreement need not be used. Instead, the member control agreement functions like a partnership agreement. It incorporates the governance and management provisions of the LLC.

c. Member control agreement

If the LLC has an operating agreement, the member control agreement will be much like the member control agreement discussed in the corporate governance section.¹⁰⁴ However, the financial structure of the LLC may be significantly more complex. Items of income, gain, loss, or deductions may be specially allocated among the members. If special allocations are used, the requirements under section 704(b) of the Internal Revenue Code must be satisfied.¹⁰⁵

If the LLC does not have an operating agreement, the member control agreement sets forth the management and governance of the LLC, the financial structure of the LLC, and the rights and obligations of the members. In other words, under the partnership governance model, the member control agreement is analogous to a comprehensive partnership agreement. It establishes how the LLC operates and the relationship (financial and otherwise) of the members. If an LLC operates without an operating agreement, it will lack the corporate characteristic of centralized management. Thus, to be taxed as a partnership, it need only lack either continuity of life or free transferability of interests.¹⁰⁶

III. OPERATION OF NORTH DAKOTA AND MINNESOTA LLCs

Much like it is organized, an LLC operates in a hybrid fashion. The Minnesota and North Dakota statutes both incorporate features from corporate and partnership statutes.

A. POWERS OF LLCs

Like a corporation, an LLC is treated as a separate legal entity in both Minnesota and North Dakota. As a result, the powers of an LLC are nearly identical to those of a corporation.¹⁰⁷ For example, an LLC has

103. See *supra* text accompanying notes 70-76 (discussing the operating agreement).

104. See *supra* text accompanying notes 77-100 (discussing the member control agreement).

105. See, e.g., Treas. Reg. § 1.704-1(b)(5) (1993) for examples involving the use of special allocations.

106. See *supra* note 14 and accompanying text.

107. Compare N.D. CENT. CODE § 10-19.1-26 (Supp. 1993) and MINN. STAT. ANN. § 302A.161 (West 1985 & Supp. 1994) (corporate powers) with N.D. CENT. CODE § 10-32-23 (Supp. 1993) and MINN. STAT. ANN. § 322B.20 (West Supp. 1994) (LLC powers).

the power to sue and be sued, to purchase or sell property, to enter into contracts, and to borrow money in its own name.¹⁰⁸

B. CONTRIBUTIONS TO LLCs

Contributions to an LLC take the same form as contributions to a corporation.¹⁰⁹ In Minnesota, a person can make a contribution to an LLC by paying or promising to pay money, transferring or promising to transfer property, or rendering or promising to render services.¹¹⁰ Executory promises are permissible.¹¹¹ Acceptable forms a contribution may take in North Dakota include the payment of money, the transfer of property, or the provision of services.¹¹² In contrast to Minnesota, North Dakota prohibits members from contributing executory promises.¹¹³

The board of governor's¹¹⁴ determination of the value of property contributed to the LLC is presumed to be proper, provided it is reasonable and made in good faith.¹¹⁵ This provision is similar to the authority granted to the board of directors of a corporation.¹¹⁶ Whenever an LLC accepts a new contribution, the board of governors¹¹⁷ must restate the value of old contributions.¹¹⁸

C. MEMBERSHIP INTERESTS

Like a general partnership interest, a membership interest in an LLC is personal property of the member.¹¹⁹ A membership interest does

108. N.D. CENT. CODE § 10-32-23 (Supp. 1993); MINN. STAT. ANN. § 322B.20 (West Supp. 1994).

109. Compare N.D. CENT. CODE § 10-19.1-63(1)(a) (Supp. 1993) and MINN. STAT. ANN. § 302A.405, subd. 1(a) (West 1985 & Supp. 1994) (contributions to a corporation) with N.D. CENT. CODE § 10-32-56(2) (Supp. 1993) and MINN. STAT. ANN. § 322B.40, subd. 2 (West Supp. 1994) (contributions to an LLC).

110. MINN. STAT. ANN. § 322B.40, subd. 2 (West Supp. 1994).

111. *Id.*

112. N.D. CENT. CODE § 10-32-56(2) (Supp. 1993).

113. *Id.*

114. In Minnesota and North Dakota, an agreement may allocate the authority ordinarily exercised by the board of governors to the members. N.D. CENT. CODE §§ 10-32-69, 10-32-50(2) (Supp. 1993); MINN. STAT. ANN. §§ 322B.606, subd. 1; 322B.37, subd. 2 (West Supp. 1994).

115. N.D. CENT. CODE § 10-32-56(4) (Supp. 1993); MINN. STAT. ANN. § 322B.40, subd. 4 (West Supp. 1994).

116. Compare N.D. CENT. CODE § 10-19.1-63(2) (Supp. 1993) and MINN. STAT. ANN. § 302A.405, subd. 2 (West 1985 & Supp. 1994) (determination of corporate board of directors) with N.D. CENT. CODE § 10-32-56(4) (Supp. 1993) and MINN. STAT. ANN. § 322B.40, subd. 4 (West Supp. 1994) (determination of LLC board of governors).

117. See *supra* note 114.

118. N.D. CENT. CODE § 10-32-57 (Supp. 1993); MINN. STAT. ANN. § 322B.41 (West Supp. 1993).

119. Compare N.D. CENT. CODE § 45-08-03 (1993) and MINN. STAT. ANN. § 323.25 (West 1991) (partnership interest is personal property) with N.D. CENT. CODE § 10-32-28(1) (Supp. 1993) and MINN. STAT. ANN. § 322B.30, subd. 1 (West Supp. 1994) (LLC membership interest is personal property).

not entitle a member to specific LLC property.¹²⁰ It consists of financial rights¹²¹ and governance rights.¹²²

1. *Right to Share Profit and Loss*

Members of an LLC share profit and loss in proportion to the value of the contributions received, unless otherwise agreed in the articles of organization or the member control agreement.¹²³ This provision is similar to the default rule found in limited partnership statutes.¹²⁴

2. *Preemptive Rights*

Unless denied in the articles of organization or in the member control agreement, members of an LLC have preemptive rights to make additional contributions before contributions from other persons are accepted.¹²⁵ This tracks the statutory provisions on preemptive rights in a corporation.¹²⁶

3. *Limited Liability*

A member of an LLC generally is not personally liable for the obligations of the LLC.¹²⁷ By statute, however, the doctrine of piercing the corporate veil is expressly made applicable to Minnesota and North Dakota LLCs.¹²⁸ Courts have used this doctrine sparingly with corporations.¹²⁹ Likely, the same approach will be taken with LLCs.

120. N.D. CENT. CODE § 10-32-28(1) (Supp. 1993); MINN. STAT. ANN. § 322B.30, subd. 1 (West Supp. 1994).

121. See *infra* text accompanying note 148 (defining financial rights).

122. See *infra* text accompanying note 149 (defining governance rights).

123. N.D. CENT. CODE § 10-32-36 (Supp. 1993); MINN. STAT. ANN. § 322B.326 (West Supp. 1994).

124. Compare N.D. CENT. CODE § 45-10.1-32 (1993) and MINN. STAT. ANN. § 322A.40 (West 1981 & Supp. 1994) (right to share profit and loss in a limited partnership) with N.D. CENT. CODE § 10-32-36 (Supp. 1993) and MINN. STAT. ANN. § 322B.326 (West Supp. 1994) (right to share profit and loss in an LLC).

125. N.D. CENT. CODE § 10-32-37 (Supp. 1993); MINN. STAT. ANN. § 322B.33 (West Supp. 1994).

126. Compare N.D. CENT. CODE § 10-19.1-65(1) (Supp. 1993) and MINN. STAT. ANN. § 302A.413, subd. 1 (West 1985) (preemptive rights in a corporation) with N.D. CENT. CODE § 10-32-37 (Supp. 1993) and MINN. STAT. ANN. § 322B.33 (West Supp. 1994) (preemptive rights in an LLC).

127. N.D. CENT. CODE § 10-32-29(1) (Supp. 1993); MINN. STAT. ANN. § 322B.303, subd. 1 (West Supp. 1994).

128. N.D. CENT. CODE § 10-32-29(3) (Supp. 1993); MINN. STAT. ANN. § 322B.303, subd. 2 (West Supp. 1994).

129. Generally, the doctrine of piercing the corporate veil is only used by the courts when the privilege of operating in the corporate form is abused. For example, if a corporation is thinly capitalized, corporate formalities are ignored, or shareholder and corporate assets are commingled, a court is likely to pierce the corporate veil. It will then hold the shareholders personally liable for corporate obligations. See, e.g., *Hilzendager v. Skwarok*, 335 N.W.2d 768 (N.D. 1983); *White v. Jorgenson*, 322 N.W.2d 607 (Minn. 1981).

4. *Voting Rights of Members*

Unless otherwise agreed in the articles of organization or the member control agreement, members of an LLC have voting power in proportion to the value of their contributions to the LLC.¹³⁰ Like shareholders in a corporation, members of an LLC may vote by proxy.¹³¹ In addition, members, like shareholders, may enter into voting agreements.¹³² Such agreements are typically used by members to combine their voting power with others who share their views, thereby ensuring a majority voting block.

5. *Right to Inspect Books and Records*

A member of an LLC has an absolute right, upon making a written demand, to examine and copy the books and records of the LLC.¹³³ This right is analogous to the inspection rights enjoyed by shareholders of a corporation and by partners in a partnership.¹³⁴

6. *Rights of Dissenting Members*

Unless waived in the member control agreement,¹³⁵ members of an LLC generally have dissenters' rights.¹³⁶ These rights are analogous to the dissenters' rights of corporate shareholders.¹³⁷ For example, a member of an LLC may dissent from the following LLC actions: certain amendments to the articles of organization;¹³⁸ a sale or lease of substan-

130. N.D. CENT. CODE § 10-32-45(2) (Supp. 1993); MINN. STAT. ANN. § 322B.356, subd. 2 (West Supp. 1994).

131. N.D. CENT. CODE § 10-32-48 (Supp. 1993); MINN. STAT. ANN. § 322B.363 (West Supp. 1994).

132. N.D. CENT. CODE § 10-32-49 (Supp. 1993); MINN. STAT. ANN. § 322B.366 (West Supp. 1994).

133. N.D. CENT. CODE § 10-32-51(2) (Supp. 1993); MINN. STAT. ANN. § 322B.373(2) (West Supp. 1994).

134. Compare N.D. CENT. CODE § 10-19.1-84(4) (Supp. 1993), MINN. STAT. ANN. § 302A.461, subd. 4 (West Supp. 1994) (rights of shareholders to inspect books and records), N.D. CENT. CODE § 45-07-02 (1993) and MINN. STAT. ANN. § 323.18 (West 1981) (rights of partners to inspect books and records) with N.D. CENT. CODE § 10-32-51(2) (Supp. 1993) and MINN. STAT. ANN. § 322B.372, subd. 2 (West Supp. 1994) (rights of LLC member to inspect books and records).

135. See N.D. CENT. CODE § 10-32-50(5) (Supp. 1993); MINN. STAT. ANN. § 322B.37, subd. 3(c) (West Supp. 1994).

136. N.D. CENT. CODE. §§ 10-32-54 to -55 (Supp. 1993); MINN. STAT. ANN. §§ 322B.383 - .386 (West Supp. 1994).

137. Compare N.D. CENT. CODE § 10-19.1-87 (Supp. 1993) and MINN. STAT. ANN. § 302A.471 (West 1985 & Supp. 1994) (corporate dissenters' rights) with N.D. CENT. CODE. § 10-32-54 (Supp. 1993) and MINN. STAT. ANN. § 322B.383 (West Supp. 1994) (LLC dissenters' rights).

138. N.D. CENT. CODE § 10-32-54(1)(a) (Supp. 1993); MINN. STAT. ANN. § 322B.383, subd. 1(1) (West Supp. 1994).

tially all of the assets of the LLC not done in the ordinary course of business;¹³⁹ or a plan of merger to which the LLC is a party.¹⁴⁰

Once a member of an LLC receives notice from the LLC that a proposed action giving rise to dissenters' rights will be voted upon, the member must take certain steps to preserve his or her dissenters' rights.¹⁴¹ First, prior to the vote on the proposed action, the member must file a written notice of his or her intent to exercise dissenters' rights with the LLC.¹⁴² Then, the member must not vote in favor of the proposed action.¹⁴³ Finally, within thirty days after the appropriate notice is given by the LLC, the member must demand payment for his or her membership interest.¹⁴⁴ Payment is made based upon the fair value of the membership interest.¹⁴⁵

IV. TRANSFER OF NORTH DAKOTA AND MINNESOTA LLC MEMBERSHIP INTERESTS

If an LLC uses the corporate model of governance, it has two of the four corporate characteristics: (1) limited liability; and (2) centralized management. Thus, to be taxed as a partnership, a corporate model LLC's membership interests must not be freely transferable, nor can the LLC have continuity of life. If an LLC uses the partnership model of governance, it still has limited liability, but lacks centralized management. Thus, to be taxed as a partnership, a partnership model LLC must lack either free transferability of interests or continuity of life.¹⁴⁶ Therefore, an LLC membership interest is divided into financial rights and governance rights to ensure that the LLC will lack the corporate characteristic of free transferability of interests.¹⁴⁷ Financial rights are defined as a member's rights to share in profits and losses, share in distributions, receive interim distributions, and receive termination distributions.¹⁴⁸ Governance rights are defined as all rights other than financial rights and the

139. N.D. CENT. CODE § 10-32-54(1)(b) (Supp. 1993); MINN. STAT. ANN. § 322B.383, subd. 1(2) (West Supp. 1994).

140. N.D. CENT. CODE. § 10-32-54(1)(c) (Supp. 1993); MINN. STAT. ANN. § 322B.383, subd. 1(3) (West Supp. 1994).

141. N.D. CENT. CODE § 10-32-55 (Supp. 1993); MINN. STAT. ANN. § 322B.386 (West Supp. 1994).

142. N.D. CENT. CODE § 10-32-55(3) (Supp. 1993); MINN. STAT. ANN. § 322B.386, subd. 3 (West Supp. 1994).

143. N.D. CENT. CODE § 10-32-55(3) (Supp. 1993); MINN. STAT. ANN. § 322B.386, subd. 3 (West Supp. 1994).

144. N.D. CENT. CODE. § 10-32-55(5) (Supp. 1993); MINN. STAT. ANN. § 322B.386, subd. 4(B) (West Supp. 1994).

145. N.D. CENT. CODE § 10-32-55(6) (Supp. 1993); MINN. STAT. ANN. § 322B.386, subd. 5 (West Supp. 1994).

146. See *supra* note 14 and accompanying text.

147. Bishop & Kleinberger, *supra* note 3, at 20.

148. N.D. CENT. CODE § 10-32-02(17) (Supp. 1993); MINN. STAT. ANN. § 322B.03, subd. 19 (West Supp. 1994).

right to assign financial rights.¹⁴⁹ Different rules apply to the transfer of each type of right.¹⁵⁰

A. TRANSFER OF FINANCIAL RIGHTS

In Revenue Ruling 88-76,¹⁵¹ the members of an LLC were free to transfer the right to share in profits to one who was not a member of the LLC.¹⁵² The transferee could not become a substitute member and did not acquire the attributes of the transferring member's interest (i.e., the right to participate in management), unless all remaining members approved the transfer. Based on these facts, the Internal Revenue Service ruled that the LLC did not possess the corporate characteristic of free transferability of interests.¹⁵³

The transfer of the right to share in profits alone, without any other ownership attributes, is the equivalent of financial rights as defined by the North Dakota and Minnesota LLC acts. The right to participate in management is the equivalent of governance rights as defined by the North Dakota and Minnesota statutes. Revenue Ruling 88-76 makes it clear that members of an LLC may freely transfer their financial rights; however, the transfer of governance rights requires the unanimous consent of all remaining members.

The North Dakota and Minnesota LLC acts were drafted based on Revenue Ruling 88-76. The transfer provisions were borrowed from the Uniform Limited Partnership Act.¹⁵⁴ In North Dakota and Minnesota, unless otherwise agreed,¹⁵⁵ a member's financial rights are freely and voluntarily transferable to a third party without the consent of the other members.¹⁵⁶ An assignee of financial rights is entitled to receive the assignor's share of profits, losses, and distributions, but he or she is prohibited from controlling the assignor's exercise of governance rights.¹⁵⁷

149. N.D. CENT. CODE § 10-32-02(20) (Supp. 1993); MINN. STAT. ANN. § 322B.03, subd. 22 (West Supp. 1994).

150. Bishop & Kleinberger, *supra* note 3, at 20.

151. 1988-2 C.B. 360.

152. Rev. Rul. 88-76, 1988-2 C.B. 360.

153. *Id.* at 361.

154. Compare N.D. CENT. CODE §§ 45-10.1-43 to -44 (1993) and MINN. STAT. ANN. §§ 322A.56 - .57 (West 1981) (assignment of limited partnership interest) with N.D. CENT. CODE §§ 10-32-31 to -34 (Supp. 1993) and MINN. STAT. ANN. §§ 322B.31 - .32 (West Supp. 1994) (assignment of financial rights of an LLC).

155. A restriction on the transfer of financial rights may be agreed to by the members in: (1) the articles of organization; (2) an operating agreement; or (3) a member control agreement. N.D. CENT. CODE § 10-32-31(3) (Supp. 1993); MINN. STAT. ANN. § 322B.31, subd. 3 (West Supp. 1994).

156. N.D. CENT. CODE § 10-32-31(1) (Supp. 1993); MINN. STAT. ANN. § 322B.31, subd. 1 (West Supp. 1994).

157. N.D. CENT. CODE § 10-32-31(2) (Supp. 1993); MINN. STAT. ANN. § 322B.31, subd. 2 (West Supp. 1994).

In addition to the voluntary transfer of financial rights, a judgment creditor of a North Dakota or Minnesota LLC member can involuntarily charge that member's financial rights with payment of an unsatisfied judgment.¹⁵⁸ Such an involuntary transfer does not give the creditor any right to exercise governance rights or become a member of the LLC.¹⁵⁹ The creditor is only entitled to the member's share of profit, loss, and distributions.¹⁶⁰

Neither voluntary nor involuntary assignments of financial rights dissolve an LLC.¹⁶¹ A dissolution does not occur because an assignee of financial rights does not become a member of the LLC.¹⁶² Thus, the free transferability of financial rights does not cause a North Dakota or Minnesota LLC to have the corporate characteristic of free transferability of interest.¹⁶³

B. TRANSFER OF GOVERNANCE RIGHTS

To ensure that free transferability of interest does not exist, LLC governance rights must not be freely transferable. In both North Dakota and Minnesota, an LLC member must have the consent of the requisite number of members before he or she transfers governance rights to a person who is not a member.¹⁶⁴ This consent cannot be given in advance through the use of a member control agreement.¹⁶⁵ Currently, North Dakota and Minnesota treat consent to transfer governance rights differently.¹⁶⁶

1. *North Dakota Transfer Consent*

In North Dakota, the transfer of governance rights to a person who is not currently a member of the LLC requires the written, unanimous consent of all other members.¹⁶⁷ A member may, however, transfer governance rights to another current member without the consent of any other

158. N.D. CENT. CODE § 10-32-34 (Supp. 1993); MINN. STAT. ANN. § 322B.32 (West Supp. 1994).

159. N.D. CENT. CODE § 10-32-34 (Supp. 1993); MINN. STAT. ANN. § 322B.32 (West Supp. 1994).

160. N.D. CENT. CODE § 10-32-34 (Supp. 1993); MINN. STAT. ANN. § 322B.32 (West Supp. 1994).

161. N.D. CENT. CODE § 10-32-31(2) (Supp. 1993) and MINN. STAT. ANN. § 322B.31, subd. 2 (West Supp. 1994).

162. N.D. CENT. CODE § 10-32-31(2) (Supp. 1993) and MINN. STAT. ANN. § 322B.31, subd. 2 (West Supp. 1994).

163. Priv. Ltr. Rul. 94-25-013 (March 23, 1994); Priv. Ltr. Rul. 93-50-013 (Sept. 15, 1993).

164. N.D. CENT. CODE § 10-32-32(2) (Supp. 1993); MINN. STAT. ANN. §§ 322B.115, subd. 2(19); 322B.313, subd. 2 (West Supp. 1994).

165. N.D. CENT. CODE § 10-32-50 (1)(c) (1993); MINN. STAT. ANN. § 322B.37, subd. 1.

166. Compare N.D. CENT. CODE § 10-32-32(2) (Supp. 1993) (providing that consent to transfer must be unanimous) with MINN. STAT. ANN. §§ 322B.115, subd. 2(19) and 322B.313, subd. 2 (West Supp. 1994) (providing that consent to transfer may be given by fewer than all members).

167. N.D. CENT. CODE § 10-32-32(2) (Supp. 1993).

member.¹⁶⁸ The statutory requirement of unanimous consent to transfer governance rights to a nonmember means that North Dakota LLCs lack the corporate characteristic of free transferability of interests.¹⁶⁹

Such a requirement may, however, present practical problems for a North Dakota LLC member who wants to get out of the business. Getting the unanimous consent of all other members may be difficult. For example, assume A, B, C, and D form a North Dakota LLC. When the LLC is formed, the four members have a good working relationship. They enter into a member control agreement setting forth their relationship.¹⁷⁰ As time goes on, A finds himself increasingly at odds with B. The relationship between A and B deteriorates to the point that A decides to sell his interest. He finds a willing buyer, E. C and D agree to consent to A's transfer of his governance rights to E. Because of their personal differences, B refuses to consent to A's transfer of his governance rights to E. Where does that leave A? Because A does not have the unanimous consent of all other members, any attempted transfer of his governance rights to E is ineffective.¹⁷¹ Thus, A may not sell his membership interest to E. Instead, he must find another exit strategy.¹⁷²

2. *Minnesota Transfer Consent*

In 1993, Minnesota amended its LLC act to allow a member to transfer governance rights to a nonmember with less than unanimous consent of all other members.¹⁷³ Under the Minnesota act, as amended, a provision allowing the transfer of governance rights with less than unanimous consent must be set forth in the articles of organization or in the member control agreement.¹⁷⁴

The treasury regulation upon which Minnesota modeled its amended LLC act focused on the consent of those members owning "substantially all" of the interests in the organization.¹⁷⁵ Thus, it appears that the Internal Revenue Service does not require unanimous consent to lack free

168. *Id.*

169. Priv. Ltr. Rul. 94-25-013 (March 23, 1994).

170. See *supra* note 165 and accompanying text (explaining that a member control agreement may not include an agreement to give transfer consent).

171. N.D. CENT. CODE § 10-32-32(5) (Supp. 1993).

172. One option A would have is to sell to C and/or D, who are already members. See *supra* notes 167-168 and accompanying text.

173. 1993 Minn. Laws ch. 137, § 36 (codified at MINN. STAT. ANN. § 322B.313, subd. 2 (West Supp. 1994)) (allowing nonunanimous consent to transfer governance rights if such a provision is set forth in either the articles of organization or the member control agreement); 1993 Minn. Laws ch. 137, § 24 (codified at MINN. STAT. ANN. § 322B.115, subd. 2(19) (West Supp. 1994)) (allowing articles of organization to be modified to allow nonunanimous consent to transfer governance rights).

174. MINN. STAT. ANN. § 322B.313, subd. 2 (West Supp. 1994).

175. Treas. Reg. § 301.7701-2(e)(1) (1993). Unfortunately, the treasury regulation does not define what is meant by "substantially all."

transferability of interests. Rather, the consent of "substantially all" is sufficient to lack free transferability of interests.

A private letter ruling confirmed this approach.¹⁷⁶ In that ruling, a Texas LLC requested the Internal Revenue Service to rule that it be classified as a partnership for federal income tax purposes. The Texas LLC act provided that an assignee of a membership interest could become a member if the LLC's regulations (operating agreement) so provided or all members consented. The LLC's regulations required the consent of the manager or a majority in interest of the members. Based on these facts, the Internal Revenue Service ruled that the Texas LLC lacked the corporate characteristic of free transferability of interests.

The Internal Revenue Service reached the same conclusion as a result of a private letter ruling request by a Minnesota LLC.¹⁷⁷ The member control agreement of the Minnesota LLC allowed a member to transfer his governance rights to a nonmember if a "majority in interest of the members" of the LLC consented to the transfer. The Internal Revenue Service ruled that the Minnesota LLC lacked the characteristic of free transferability of interests even though its members could transfer their governance rights to nonmembers with less than unanimous consent.

In the wake of the Minnesota private letter ruling, what remains unclear is exactly what is meant by "a majority in interest." The Internal Revenue Service did not define the term in its ruling. It is likely that guidance from the Service on this issue will be forthcoming in the near future. Attorneys drafting member control agreements in Minnesota should keep abreast of the latest developments in this area.

3. *Comparison of North Dakota and Minnesota Transfer Consent*

Based on the treasury regulation and recent private letter rulings, it appears that a majority in interest requirement to give transfer consent is sufficient to avoid the corporate characteristic of free transferability of interests. Because of the amendments to the Minnesota LLC act, Minnesota LLC members do not face the practical problem of obtaining the unanimous consent of all members that North Dakota LLC members currently face. Although guidance from the Internal Revenue Service is still needed on what a majority in interest requirement means, the Minnesota approach, despite its uncertainty, is more workable than North Dakota's unanimity requirement. North Dakota should follow Minnesota's lead

176. Priv. Ltr. Rul. 92-10-019 (Dec. 6, 1991).

177. Priv. Ltr. Rul. 93-50-013 (Sept. 15, 1993).

and change its unanimous consent requirement to a majority in interest requirement.

V. TERMINATION OF NORTH DAKOTA AND MINNESOTA LLCs

For an LLC to lack the corporate characteristic of continuity of life, it must have a limited period of duration.¹⁷⁸ In Minnesota and North Dakota, an LLC dissolves upon the occurrence of any of the following events: (1) the period stated in the articles of organization expires; (2) a court orders dissolution of the LLC; (3) the organizers dissolve the LLC; (4) the members dissolve the LLC; (5) any member dies; (6) any member retires; (7) any member resigns; (8) any member's interest is completely redeemed; (9) any member's governance rights are assigned; (10) any member is expelled; (11) any member declares bankruptcy; (12) the dissolution of any member; (13) any merger in which the LLC is not a surviving organization; (14) an exchange in which the LLC is not the acquiring corporation; and (15) any other event that terminates the continued membership of a member in the LLC.¹⁷⁹ Currently, North Dakota and Minnesota treat LLC dissolution avoidance consent and business continuation agreements differently.

A. DISSOLUTION AVOIDANCE CONSENT

1. *North Dakota Dissolution Avoidance Consent*

In North Dakota, the maximum period that an LLC can exist is thirty years.¹⁸⁰ If, however, an event of dissolution occurs before the thirty-year period has expired, the life of an LLC may be terminated earlier.¹⁸¹ The remaining members may avoid such a termination if they give dissolution avoidance consent.¹⁸²

"Dissolution avoidance consent" is defined as the consent of all remaining members, after a dissolution event, to continue the LLC as a legal entity.¹⁸³ To be effective, a dissolution avoidance consent must be authorized by the articles of organization and must be obtained from all remaining members no later than ninety days after the occurrence of the dissolution event.¹⁸⁴ In North Dakota, a dissolution avoidance consent

178. See *supra* notes 14-16 and accompanying text.

179. N.D. CENT. CODE § 10-32-109(1) (Supp. 1993); MINN. STAT. ANN. § 322B.80, subd. 1 (West Supp. 1994).

180. N.D. CENT. CODE § 10-32-07(1)(e) (Supp. 1993).

181. This requirement is necessary in order for the LLC to lack the corporate characteristic of continuity of life. See *supra* notes 15-16 and accompanying text (discussing continuity of life).

182. N.D. CENT. CODE § 10-32-109(1) (Supp. 1993).

183. N.D. CENT. CODE § 10-32-02(14) (Supp. 1993).

184. N.D. CENT. CODE § 10-32-109(1) (Supp. 1993).

may not be entered into by the members before an event of dissolution; it may only be entered into after an event of dissolution has occurred.¹⁸⁵

North Dakota LLCs may find it difficult to avoid dissolution in view of the fact that all remaining members must give dissolution avoidance consent, and such consent may only be given after an event of dissolution. For example, assume that A, B, C, and D form a North Dakota LLC. The articles of organization authorize the members to consent to avoid dissolution after the occurrence of an event of dissolution. The members also enter into a member control agreement, which may not contain an agreement to give dissolution avoidance consent prior to an event of dissolution.¹⁸⁶ A unexpectedly dies. C and D want to continue the business and consent to avoid dissolution within ninety days after A's death. B does not consent. Because dissolution avoidance consent is not received from B within ninety days after A's death, the North Dakota LLC is dissolved despite the fact that C and D want to continue the business.

2. *Minnesota Dissolution Avoidance Consent*

Minnesota's LLC act was amended in 1993 to allow an LLC's articles of organization to authorize a period of existence longer than thirty years.¹⁸⁷ As in North Dakota, the occurrence of an event of dissolution may shorten the life of a Minnesota LLC.¹⁸⁸ The remaining members may avoid such a termination by giving dissolution avoidance consent.¹⁸⁹

Minnesota treats consent to avoid dissolution more flexibly than North Dakota. In 1993, Minnesota amended its LLC act to allow less than unanimous consent of all members to avoid dissolution.¹⁹⁰ This change was made to allow a Minnesota LLC to avoid dissolution if a majority in interest of the remaining members agree to continue after an event of dissolution. Such a provision is required to be set forth in the articles of organization of the LLC.¹⁹¹

185. See *supra* note 183 and accompanying text. In contrast to the North Dakota LLC Act, the Minnesota Act allows members of an LLC to enter into an agreement to give dissolution avoidance consent prior to the occurrence of an event of dissolution. See MINN. STAT. ANN. § 322B.03, subd. 4 (West Supp. 1994).

186. See *supra* note 183 and accompanying text.

187. See *supra* note 57 and accompanying text.

188. Once again, this requirement is necessary in order for the LLC to lack the corporate characteristic of continuity of life. See *supra* notes 15-16 and accompanying text (discussing continuity of life).

189. MINN. STAT. ANN. § 322B.80, subd. 1 (West Supp. 1994).

190. 1993 Minn. Laws ch. 137, § 24 (codified at MINN. STAT. ANN. § 322B.115, subd. 2(20)) and 1993 Minn. Laws ch. 137, § 46 (codified at MINN. STAT. ANN. § 322B.80, subd. 1(5)).

191. 1993 Minn. Laws ch. 137, § 24 (codified at MINN. STAT. ANN. § 322B.115, subd. 2(20)) and 1993 Minn. Laws ch. 137, § 46 (codified at MINN. STAT. ANN. § 322B.80, subd. 1(5)).

In Minnesota, members of an LLC may also agree in advance (using a member control agreement) to give dissolution avoidance consent.¹⁹² Such an agreement is not specifically enforceable.¹⁹³ If a member breaches an agreement to give dissolution avoidance consent, however, the breaching member may be liable for damages for breach of contract.¹⁹⁴

The Internal Revenue Service recently ruled that a Minnesota LLC lacked the corporate characteristic of continuity of life based on the following facts: The articles of organization of a Minnesota LLC contained a provision granting a "majority in interest of the remaining members" the power to avoid dissolution by giving their consent to avoid dissolution no later than ninety days after the event of dissolution. The member control agreement did not, however, contain an agreement to give dissolution avoidance consent in advance of an event of dissolution. The Internal Revenue Service reasoned that because the Minnesota LLC act and the member control agreement provided for dissolution upon the occurrence of a dissolution event, unless a majority in interest of the remaining members agreed to continue the business, the Minnesota LLC did not have continuity of life.¹⁹⁵

3. *Comparison of North Dakota and Minnesota Dissolution Avoidance Consent Requirements*

There are two significant differences between the North Dakota and Minnesota dissolution avoidance consent provisions. First, after an event of dissolution has occurred, the remaining members in North Dakota must unanimously consent to avoid dissolution.¹⁹⁶ In Minnesota, only a majority in interest of the remaining members need to consent to avoid dissolution.¹⁹⁷ The Internal Revenue Service indicated in the Minnesota private letter ruling that a majority in interest requirement does not create continuity of life.¹⁹⁸ Therefore, despite the uncertainty of the mean-

192. MINN. STAT. ANN. § 322B.03, subd. 4 (West Supp. 1994). The statute defines an agreement to give dissolution avoidance consent as a member control agreement in which the members agree in advance that if the "continued membership of any member is terminated through an event covered in the agreement, then each remaining member shall give dissolution avoidance consent." *Id.*

193. MINN. STAT. ANN. § 322B.37, subd. 3(b) (West Supp. 1994). The reason that an agreement to give dissolution avoidance consent is not specifically enforceable in Minnesota is so that the characteristic of continuity of life does not exist. North Dakota has no comparable provision.

194. MINN. STAT. ANN. § 322B.306, subd. 4 (West Supp. 1994) (providing for wrongful dissociation if dissolution avoidance consent is obtained); MINN. STAT. ANN. § 322B.873, subd. 4 (West Supp. 1994) (providing for wrongful dissociation if dissolution avoidance consent is not obtained).

195. Priv. Ltr. Rul. 93-50-013 (Sept. 15, 1993).

196. See *supra* notes 182-184 and accompanying text.

197. See *supra* note 190 and accompanying text.

198. See *supra* note 195 and accompanying text.

ing of the majority in interest requirement, the North Dakota LLC act should be amended in order to provide more flexibility for LLC members. North Dakota should change its unanimous consent requirement to a majority in interest requirement. Although some uncertainty would still remain, the practical problem of obtaining unanimous consent after an event of dissolution would be eliminated.

Second, in Minnesota, a dissolution avoidance consent may be agreed to in advance in a member control agreement.¹⁹⁹ In North Dakota, such an agreement may not be entered into before the occurrence of a dissolution event.²⁰⁰ The Internal Revenue Service has expressed doubt about members agreeing in advance to continue the entity if a dissolution event should occur.²⁰¹ Therefore, practitioners who are drafting LLC documents in Minnesota should not include an agreement to give dissolution consent in a member control agreement.²⁰² Until the Internal Revenue Service position changes, North Dakota is wise to continue to prohibit agreements to enter into dissolution avoidance consent prior to an event of dissolution.

B. BUSINESS CONTINUATION AGREEMENTS

If a dissolution event occurs and the requisite number of members do not consent to avoid dissolution, the LLC must legally dissolve.²⁰³ However, the members can still agree to continue the business in a successor organization. Such an agreement is called a business continuation agreement. North Dakota and Minnesota define business continuation agreements slightly differently.

1. *North Dakota Business Continuation Agreements*

In North Dakota, a business continuation agreement is defined as a member control agreement made after the LLC has incurred an event of dissolution, under which the members agree that the business of the dissolved LLC will be continued in a successor organization.²⁰⁴ In order for a business continuation agreement to be effective, the articles of organization must authorize the members to enter into such an agreement²⁰⁵ and

199. See *supra* note 192 and accompanying text.

200. See *supra* note 183 and accompanying text.

201. Carter G. Bishop & Daniel S. Kleinberger, *Structuring the Minnesota LLC*, BENCH & BAR OF MINNESOTA, November 1993, 23, 24.

202. *Id.*

203. N.D. CENT. CODE § 10-32-109(1) (Supp. 1993); MINN. STAT. ANN. § 322B.80, subd. 1 (West Supp. 1994).

204. N.D. CENT. CODE § 10-32-02(7)(a) (Supp. 1993).

205. N.D. CENT. CODE § 10-32-07(1)(g) (Supp. 1993).

all members must enter into the agreement.²⁰⁶ A member control agreement may include a business continuation agreement.²⁰⁷

Currently, under North Dakota law, it is unclear whether a business continuation agreement may be entered into prior to an event of dissolution. By definition, a business continuation agreement can be entered into only after the LLC has incurred an event of dissolution.²⁰⁸ However, a member control agreement, which will generally be entered into prior to an event of dissolution, may include a business continuation agreement.²⁰⁹ Because of this uncertainty, practitioners who are drafting LLC documents in North Dakota are wise to not include an advance agreement to continue the business. The articles of organization may continue, however, to empower the members to enter into a business continuation agreement.²¹⁰ As long as such an agreement is entered into by all members after an event of dissolution, it is clear that it does not violate North Dakota law nor jeopardize the LLC's partnership tax status.²¹¹

2. *Minnesota Business Continuation Agreements*

In Minnesota, a business continuation agreement may be entered into before or after an LLC has incurred an event of dissolution.²¹² As in North Dakota, the articles of organization must empower the members to enter into a business continuation agreement²¹³ and all members must enter into the agreement.²¹⁴

Under Minnesota law, it is clear that a business continuation agreement may be entered into by the members before an event of dissolution occurs;²¹⁵ however, to do so would likely put the LLC's partnership tax status in jeopardy.²¹⁶ In a recent private letter ruling involving a Minnesota LLC, the articles of organization of the LLC had empowered the members to enter into a member control agreement.²¹⁷ However, the member control agreement did not provide for a business continuation agreement in advance of a dissolution event. Based on these facts, the Internal Revenue Service ruled that the Minnesota LLC lacked continuity of life. Additionally, the Internal Revenue Service has expressed doubt

206. N.D. CENT. CODE § 10-32-50(2) (Supp. 1993).

207. N.D. CENT. CODE § 10-32-50(1)(d) (Supp. 1993).

208. See *supra* note 204 and accompanying text.

209. See *supra* note 207 and accompanying text.

210. See *supra* note 205 and accompanying text.

211. See *supra* note 204 and accompanying text; see also Priv. Ltr. Rul. 93-50-013 (Sept. 15, 1993).

212. MINN. STAT. ANN. § 322B.03, subd. 9 (West Supp. 1994).

213. MINN. STAT. ANN. § 322B.115, subd. 1(6) (West Supp. 1994).

214. MINN. STAT. ANN. § 322B.37, subd. 2 (West Supp. 1994).

215. See *supra* note 212 and accompanying text.

216. Bishop & Kleinberger, *supra* note 201, at 26.

217. Priv. Ltr. Rul. 93-50-013 (Sept. 15, 1993).

about members agreeing in advance to continue the entity's business in the event of a dissolution.²¹⁸

3. *Comparison of North Dakota and Minnesota Business Continuation Agreements*

North Dakota law is currently unclear as to whether members of a North Dakota LLC may, prior to an event of dissolution, enter into an agreement to continue the business. Minnesota law clearly allows members of a Minnesota LLC to enter into such an agreement. However, the Internal Revenue Service has expressed doubts about whether members can enter into such agreements without creating continuity of life in the LLC. Thus, at the present time, it appears that an advance agreement to continue the business of the LLC in a successor form should be avoided both in North Dakota and Minnesota.

VI. CONCLUSION

An LLC offers business owners the unique opportunity to combine the tax advantages of a partnership with the limited liability of a corporation. It is a powerful new planning tool for North Dakota and Minnesota business owners. Before counseling a business owner interested in organizing a North Dakota or Minnesota LLC, however, it is important to become familiar with the North Dakota and Minnesota statutes. While the North Dakota and Minnesota LLC acts are similar, there are also some current differences. These differences must be kept in mind when advising clients in North Dakota or Minnesota. Moreover, since the law is rapidly changing in this area, practitioners are cautioned to keep abreast of the changes.

218. Bishop & Kleinberger, *supra* note 201, at 24.