2016 PENNSYLVANIA LEGISLATIVE DEVELOPMENTS

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The Pennsylvania laws on unincorporated entities were substantially revised by Act 2016-170 which takes effect on February 21, 2017. The most significant changes made by Act 2016-170 are to:

1. conform the provisions of Chapter 82 regarding limited liability partnerships to the substance of the provisions on limited liability partnerships found in the Uniform Partnership Act (1997) (Last Amended 2013) (the “UPA”);

2. replace existing Chapter 83 regarding general partnerships with the UPA;

3. replace existing Chapter 85 regarding limited partnerships with the Uniform Limited Partnership Act (2001) (Last Amended 2013) (the “ULPA”); and

4. replace existing Chapter 89 regarding limited liability companies with the Uniform Limited Liability Company Act (2006) (Last Amended 2013) (the “ULLCA”).

Limited Liability Partnerships

The Pennsylvania law on limited liability partnerships (“LLPs”) is found in Chapter 82 of Title 15 of the Pennsylvania Consolidated Statutes (“Chapter 82”), which was enacted in 1994. When Chapter 82 was first enacted, the concept of an LLP was relatively new and the law was not yet well developed. In the succeeding years, LLPs have become better understood, and the issues involving LLPs are more defined. The substantive changes to Chapter 82 made by Act 2016-170 include the following:

Liability Shield for General Partners

Chapter 82 originally followed the pattern of LLP statutes as they were first enacted in the 1990s and protected the general partners of an LLP from personal liability for tort liabilities of the partnership, but not contractual obligations. The majority of state LLP statutes have since been amended to provide general partners with the same liability protection that is available to shareholders of a corporation and members of a limited liability company. The UPA has also adopted that approach. Act 2016-170 follows the majority of states and the UPA and has provided a full shield for general partners of an LLP. See 15 Pa.C.S. § 8204.
Distribution Tests

Pennsylvania law prior to the enactment of Act 2016-170 did not restrict the payment of distributions by a general partnership or LLP to its partners. Distribution tests have not historically been applied to general partnerships because the personal liability of general partners makes those tests unnecessary and because the general partners remain liable to satisfy any obligations of the partnership that cannot be paid directly by the partnership. The UPA added distribution tests for LLPs because the liability shield of general partners might otherwise interfere with the ability of creditors to recoup improper distributions, and Act 2016-170 follows the lead of the UPA and has added distribution tests to Chapter 82 modeled after those applicable to business corporations. See 15 Pa.C.S. §§ 8231 and 8232.

Dissolution Procedures

Similar to the addition of distribution tests discussed above, the UPA has also added provisions dealing with the satisfaction of creditors when an LLP is liquidated. Again, because the liability shield for general partners in an LLP might otherwise interfere with the rights of creditors, Act 2016-170 has added procedures for liquidation of an LLP modeled on those applicable to business corporations. See 15 Pa.C.S. §§ 8241 – 8244.

General Partnerships

A general partnership exists whenever two or more persons associate together for the purpose of doing business for profit without taking steps to create an entity by a filing with the Department of State. Historically, every partner is equally able to transact business on behalf of the partnership. Creditors of the partnership are entitled to rely upon the assets of the partnership and those of every partner in the satisfaction of the partnership’s debts. General partnerships were previously governed by Chapter 83 of Title 15. Act 2016-170 has replaced Chapter 83 with a new Chapter 84 patterned after the UPA.

Nature of a Partnership

The first essential change made by Act 2016-170 concerns the nature of a partnership. Prior to Act 2016-170, Pennsylvania law on general partnerships in Chapter 83 of Title 15 did not resolve the long-standing conflict in partnership law as to whether a partnership should be considered merely an aggregation of individuals or should be regarded as an entity by itself. Thus Pennsylvania was rightly characterized as taking a hybrid approach, encompassing aspects of both theories.

The UPA makes a very clear choice that settles the controversy. To quote UPA § 201: “A partnership is an entity.” Act 2016-170 follows that approach. See 15 Pa.C.S. § 8421.
What are some of the outcomes of this decision to treat a partnership as an entity? Chapter 83 expressly permitted a partnership to hold property as a partnership. Thus a partner was treated “as a co-owner with his partners of specific partnership property holding as a tenant in partnership.” Under new Chapter 84, a partner has his or her partnership interest, but is not a co-owner of specific partnership property. The entity holds the specific property. The partners have their interest in the entity.

Dissolution of the partnership is another area in which selection of the entity versus aggregate theory makes a big difference. Dissolution occurred whenever a partner disassociated from a partnership under Chapter 83. That is always not the case under new Chapter 84.

Creation of a Partnership

Creation of a partnership requires association of two or more persons to do business for profit. The concept is not materially different between old Chapter 83 and new Chapter 84. What Chapter 84 does is to put expressly what was regarded as implied in Chapter 83. By and large the rules of Chapter 83 were regarded as default rules and applied in the event that there was no express provision in the partnership agreement. Chapter 84 clearly expresses the primacy of the partnership agreement. The agreement applies, and the rules of Chapter 84 are regarded as default rules, with the exception of certain rules that protect partners. For example, a partner’s duties of loyalty and good faith cannot be abrogated by agreement. The agreement cannot take away a partner’s right of access to the partnership books. In general, however, the partnership agreement expressly controls over the language of Chapter 84. See 15 Pa.C.S. § 8415.

Certificate of Authority

Chapter 84 continues the approach of prior law and does not require a filing in the Department of State to create a partnership, thus preserving the partnership form as the default type of organization which exists whenever the persons involved take no steps to create another form of entity. However, Chapter 84 permits a new type of filing called a “certificate of partnership authority.” The certificate can be used to limit the capacity of a partner to act as an agent of the partnership, and limit a partner’s capacity to transfer property on behalf of the partnership. Filing such a certificate is voluntary, and no partnership need file a certificate, nor is the existence of the partnership dependent upon the filing of a certificate. But the certificate, if filed, has an impact upon a third party dealing with the partnership.

The main effect of a certificate of authority is to assure a third party with knowledge of the certificate that the business of the partnership can be conducted and the partnership will be bound, if the third party deals with a partner with authority provided in the certificate. Any limitation upon a partner’s authority, however, does not affect any third party who does not know about the certificate, except as to real estate transactions. If there is a limitation in a filed certificate that is also filed in the real property records, then a third party dealing with that partner in a real estate transaction is deemed to know of the limitation. See 15 Pa.C.S. §§ 8433 and 8434.
Fiduciary Responsibilities

Former Chapter 83 had very little to say about a partner’s responsibilities to the other partners. In contrast, new Chapter 84 articulates duties of loyalty and care to which each partner is held that are consistent with customary expectations. See 15 Pa.C.S. § 8447.

Dissolution

A partnership dissolved under former Chapter 83 upon the happening of specific events, either the end of the prescribed term of the partnership, as agreed by the partners, or when a partner dissociated, rightfully or wrongfully, from the partnership. At dissolution, the business of the partnership had to be wound up and fruits of the enterprise distributed to the partners after the creditors were paid.

Automatic dissolution of the partnership after dissociation of a partner does not take place under new Chapter 84. In a partnership at will only a partner who dissociates with notice of “express will” to dissolve causes the dissolution of the partnership. Thus, if a partner is simply bought out, there is not an automatic dissolution. See 15 Pa.C.S. § 8481.

Limited Partnerships

Limited partnerships were previously governed by Chapter 85 of Title 15. Act 2016-170 has replaced Chapter 85 with a new Chapter 86 patterned after the ULPA. Chapter 86 does not change the basic structure of limited partnerships as previously defined in Chapter 85, but the Chapter 86 does improve the capacity of limited partnerships both to do business and serve the best interests of partners and third parties conducting business with the partnership.

De-linkage of the ULPA from the UPA

Unlike former Chapter 85, new Chapter 86 is a stand-alone statute, de-linked from the rules on general partnerships in the UPA. Thus Chapter 86 incorporates many provisions from general partnership law and, as a result, is more complex and noticeably longer than Chapter 85.

Dissociation of Limited Partners

An important change made by Chapter 86 concerns a limited partner’s right to disassociate from the partnership. Under former Chapter 85 a limited partner could theoretically withdraw from the partnership on six months’ notice unless the partnership agreement specified the withdrawal events for a limited partner. Due to estate planning concerns, the default rule in Chapter 86 affords no right to disassociate as a limited partner before the termination of the limited partnership. The power to disassociate is expressly recognized, but may be exercised only through the partnership agreement or those events specifically listed in Chapter 86. See 15 Pa.C.S. § 8661.
Dissolution of a Limited Partnership

Under former Chapter 85, the dissolution of the partnership entity required the unanimous, written consent of all the partners. Under Chapter 86, dissolution of the partnership only requires the consent of all the general partners and of the limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective. See 15 Pa.C.S. § 8681.

Limited Liability Companies

Limited liability companies (“LLCs”) were previously governed by Chapter 89 of Title 15. Act 2016-170 has replaced Chapter 89 with a new Chapter 88 patterned after the ULLCA.

De-linkage of LLC Law

Similar to the situation discussed above with respect to de-linkage of the law on limited partnerships from the law on general partnerships, the law on LLCs has been de-linked from the law on general partnerships and limited partnerships. Chapter 88 is a stand-alone statute; and thus is more complex and noticeably longer than former Chapter 89.

Transfer of Membership Interests

Absent an express agreement of the parties, the only interest in an LLC that may be transferred is called the “transferable interest” in new Chapter 88. A “transferable interest” is generally any right to distributions that a member has under the operating agreement. The operating agreement may impose restrictions on a right to transfer. However, the certificate of organization may provide that a “transferable interest” is freely transferable under Chapter 88. If it does, the transferable interest may be certificated in the same manner any certificated security is, and is likely to be a security under Article 8 of the Uniform Commercial Code.

Role of the Operating Agreement

Chapter 88 adopts the same approach as in Chapters 84 and 86 and makes clear that the operating agreement generally may vary the statutory default rules on LLCs except with respect to specified issues. Chapter 88 provides that the duty of loyalty and the duty of care may not be eliminated in the operating agreement, but the operating agreement may specify those acts and transactions that do not violate the duty of loyalty, so long as not manifestly unreasonable. The operating agreement may alter the duty of loyalty or duty of care, provided that eliminating them is not “manifestly unreasonable.” See 15 Pa.C.S. § 8815.

Rights of Creditors of Members
Chapter 88 restricts the interests of a creditor of a member to the member’s transferable interest and provides a judgment creditor with a “charging order” as the only method of executing against that interest. The resultant lien may be foreclosed and sold in a judicial foreclosure sale. A finding that payment may not be made within a reasonable time is required before a court orders foreclosure of the lien. A purchase in a foreclosure sale does not make the purchaser a member. See 15 Pa.C.S. § 8853.

**Power of a Member or Manager to Bind the LLC**

Chapter 88 makes an important change from the prior law by treating “statutory apparent authority” as an attribute of partnership formality that does not belong in an LLC statute. Chapter 88 provides that “a member is not an agent of the limited liability company solely by reason of being a member.” Other law—most especially the law of agency—will handle power-to-bind questions. Although conceptually innovative, this approach should not significantly alter the commercial reality that exists between limited liability companies and third parties because the vast majority of interactions between LLCs and “third parties” are common and transpire without agency law issues being recognized by the parties, let alone disputed; and when an LLC enters into a major transaction with a sophisticated third party, the third party never relies on statutory apparent authority to determine that the person purporting to act for the LLC has the authority to do so. See 15 Pa.C.S. § 8831.

**Remedy for Oppressive Conduct**

Reflecting case law developments around the country, the ULLCA permits a member (but not a transferee) to seek a court order “dissolving the company on the grounds that the managers or those members in control of the company . . . have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the [member].” This provision is necessary given the perpetual duration of an LLC formed under the ULLCA and has been adopted in Chapter 88. See 15 Pa.C.S. § 8871(a)(4).

**Derivative Claims and Special Litigation Committees**

The ULLCA contains modern provisions addressing derivative litigation, including a provision authorizing special litigation committees and subjecting their composition and conduct to judicial review. Those provisions have been included in Chapter 88. See 15 Pa.C.S. § 8881 – 8885. The Business Corporation Law and Nonprofit Corporation Law have also been conformed to the ULLCA provisions on derivative litigation by Act 2016-170.

**Benefit Companies**

Provisions have been included in new Chapter 88 that authorize the organization of benefit companies that follow the pattern of benefit corporations and are designed for use by LLCs that wish to conduct their businesses in a manner that has a material positive impact on society and the environment. See 15 Pa.C.S. §§ 8891 - 8898.