

**JOHN CUNNINGHAM'S LLC NEWSLETTER
FOR TAX AND LEGAL PROFESSIONALS**

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**THE NEW HAMPSHIRE LLC ACT: BAD NEWS FOR LLC
MEMBERS WHO LACK GOOD LAWYERS**

EXECUTIVE SUMMARY. The New Hampshire Limited Liability Company Act (the "New Hampshire Act") is gravely deficient for persons that form LLCs under it without the assistance of competent LLC lawyers. The New Hampshire Legislature should make major amendments of the Act to meet the needs of these persons.

DISCUSSION. I was privileged to be one of the drafters of the New Hampshire Act as originally enacted in 1993 and of the major amendments to it in 1997. I believe that even as currently drafted, the Act has many fine features.

However, in 1993 and even in 1997, the LLC form was new and unfamiliar, and the members of the drafting committee, including myself, could have very little idea of what kinds of New Hampshire people would be likely to use LLCs; whether these LLCs would be large or small; whether they would be simple or complex; what kinds of LLC legal issues would be likely to be important to the members of New Hampshire LLCs; and whether the members of these LLCs would typically use the help of lawyers in forming them.

In recent years, the LLC has virtually replaced all other types of entities as the entity of choice in New Hampshire and nationwide, and we have learned a great deal about New Hampshire LLCs and their members from practice experience, from IRS filing statistics, and from LLC certificates of formation on file with the New Hampshire Secretary of State. In particular, we have learned:

- That most New Hampshire LLCs have only one or two members and very limited initial capital; and
- That at least one-third of all New Hampshire LLCs have been formed without the assistance of lawyers.¹

Furthermore, we have come to understand that because of, among other factors, the numerous ownership structures and management structures potentially available to LLC members, LLC law, even in the case of relatively small and unsophisticated LLCs, can be surprisingly complex.

In my view, the above understandings about New Hampshire LLC law and usage lead remorselessly to the following conclusion: The New Hampshire Act should be drafted primarily to meet the needs of New Hampshire LLC members who cannot afford to hire lawyers to help them form their LLCs or who lack the sophistication to recognize their

¹ A statistical analysis of the first 500 LLC certificates of formation filed with the New Hampshire Secretary of State in September, 2007, may be found in my website, whose URL is www.lleformations.com, as Item 1 under the button on the website home page marked "LLC Library."

need for these lawyers. (I will refer to these members in the rest of this issue as “unrepresented members.”) More specifically, the New Hampshire Act should be drafted primarily to provide an “off-the-shelf” statutory LLC agreement for unrepresented members.

Unfortunately, the New Hampshire Act as presently drafted falls far short of meeting this standard.

To illustrate:

- 1) The structure and prose style of the New Hampshire Act. Because of its confusing overall structure and the baroque system employed in it for numbering its various provisions, it is often difficult to find sought-for provisions in the Act; and many of these provisions are written in a complex statutory legalese that is difficult not only for non-lawyers but even for LLC specialists to understand. For the benefit of unrepresented members, the Act needs to be radically restructured and it needs to be rewritten in English.
- 2) Written vs. unwritten LLC agreements under the New Hampshire Act. The New Hampshire LLC Act does not recognize LLC agreements unless they are written, and it provides, in effect, that verbal agreements are legally invalid. Thus, under the New Hampshire Act, even the most carefully negotiated agreements among LLC members will be ineffective if, as is the case with many small and informal LLCs, they are “sealed with a handshake” rather than memorialized in a formal writing.
- 3) Fiduciary rules under the New Hampshire Act. Sound, comprehensive fiduciary rules are critical for the success of most multi-member LLCs, and especially for relatively small LLCs with less sophisticated members. These rules set the ethical tone and the team spirit of an LLC and often critically affect the level of commitment of its members. However, on almost every key fiduciary issue likely to be important to unrepresented members—e.g., issues of loyalty, care, candor, good faith and fair dealing—the New Hampshire Act is either silent or gravely deficient.
- 4) Member voting under the New Hampshire Act. The New Hampshire Act provides that votes on LLC matters shall be allocated among the members on a one-member/one-vote basis. However, I suspect that in the experience of most New Hampshire LLC accountants and lawyers, a substantial majority of LLC members—and particularly those in smaller, less sophisticated LLCs—want member votes to be proportionate to member contributions.
- 5) Distributions of LLC profits under the New Hampshire Act. The New Hampshire Act provides, in effect, that an LLC may make distributions of its profits to its members only to the extent explicitly required by its LLC agreement. In practice, this means that members who need distributions to cover their taxes on LLCs profits or for unexpected family or personal needs cannot obtain them except by adopting written agreements that provide for them, or by amending LLC agreements that do not provide for these distributions.

How can we solve the serious problems posed by the New Hampshire Act for unrepresented members?

The only solution currently available for unrepresented members is to hire competent LLC lawyers to draft LLC agreements for them. However, for many of these members, this alternative, because of its expense and other factors, is impractical.

Thus, the only real solution is a massive revision of the New Hampshire Act.

I hope to begin the process of developing such a revision during the summer or fall of 2008 and to submit it to the Legislature some months thereafter. If any New Hampshire accountants or lawyers reading this newsletter are interested in assisting me in this process, I will be grateful to hear from them.

If you have comments on this column or wish to contact me for any other reason, please send me an e-mail at lawjmc@comcast.net or give me a call at (603) 228-0125. If you'd like to visit my website, the link is www.llcformations.com.

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