

# Entity Selection in the 21<sup>st</sup> Century

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# Overview

1. Business entity laws are converging
2. Point at which they will meet is zero regulation (Delaware LLCs)
3. Charter competition (not policy) is driving the change
4. When regulation is gone, “partnership,” “corporation,” “LLC,” and “limited partnership” will exit our vocabulary.

One entity type, called “entity”

No “entity choice” to teach

We will teach “entity contracting”

# 1. Entity Laws are Converging

## Examples:

Partnerships have become entities (like corporations and LLCs).

All four entity types have limited liability.

(partnerships and LPs have different procedures to get it)

Uniform Law Commission harmonized partnership, LLC, LP law

MBCA harmonizing with the ULC laws (definition of insolvency)

DGCL and MBCA are “borrowing” from each other

Steady grinding down of fiduciary duties (MFW, Corwin, etc.)

New entity types have arisen to confer new privileges (LP, LLC)

Pre-existing entity types try to offer the new privileges

New entity types try to include the old type’s privileges

Convergence resumes (with more privileges)

## 2. Zero Regulation Is the Convergence Point

The law is almost there.

Uniform **partnership**, **LLC**, and **limited partnership** laws:

Section 105: The Agreement overrides the Act except as provided in a few narrow regulatory exceptions.

**Corporation** laws:

MBCA §7.32: Shareholder agreements override statutory provisions if the overrides are “not contrary to public policy”

DGCL: Jones Apparel Group v. Maxwell Shoe (Del. Ch. 2004)  
(Strine)

1. The absence of the magic words “except as provided in the certificate . . .” doesn’t make a DGCL provision mandatory
2. Delaware is committed to private ordering.
3. Public policy is the only limit on private ordering.

# 3. Charter Competition Drives the Convergence

Going on for over a hundred years

Three motivations in recent decades:

1. States want to prove “business-friendliness” to attract jobs and revenues. An attractive entity law is a way to prove it.
2. Delaware and Nevada are after the fees and franchise taxes.
3. Law drafters (ULC, MBCA, state Bar committees) want their products to succeed

Success is business choosing the entity type they designed.

Businesses choose entity laws that (1) minimize regulation, (2) maximize freedom, and (3) confer privilege on business.

The competition is to produce those laws

Copying other state’s laws is permitted and common

Result: Competition pushes drafters to produce the same laws.

## 4. What do we teach after the Convergence?

Not partnerships, corporations, LLCs and LP. They are all the same!

We teach entity contracts: The variety of contracts by which business people finance and govern their entities.

The disappearance of entity types solves the two biggest problems in teaching business associations:

1. Too much material for a four-hour course
2. Boring to cover the same contracting four times

We will teach each contract subject once; mention all the variations.

Lynn M. LoPucki & Andrew Verstein, *Business Associations: A Systems Approach* (forthcoming, Aspen Publishing September 2020)

We've each taught the book twice.

It works.

# The Entity Vocabulary

To discuss all entity types at once require four generic terms.

| Entity                   | Shares or interests | Investors                            | Managers          | Fundamental documents              |
|--------------------------|---------------------|--------------------------------------|-------------------|------------------------------------|
| Corporation              | Shares or stock     | Shareholders or stockholders         | Directors         | Articles of incorporation, bylaws  |
| LLC                      | Interests           | Members                              | Managers          | Certificate; operating agreement   |
| Partnership (LLP)        | Interests           | Partners                             | Managing partners | Partnership agreement              |
| Limited partnership (LP) | Interests or units  | General partners<br>Limited partners | General partners  | Certificate; partnership agreement |

Each term already in use in the case law.

# The Entity Contracting We Will Teach

**Limited liability:** Every entity type has it; they get it different ways

**Finance:** (contributions and distributions) The only mandatory rules are creditor protections.

**Investor decision-making:** (1) Default rules for investor voting and (2) controlling-investor fiduciary duties

**Manager decision-making:** (1) Default rules for manager voting and (2) manager fiduciary duties

**Investor Litigation:** (Yes, there are direct and derivation actions in LLCs, limited partnership, and sometimes partnerships.)

**Investment transfer:** restriction, sale, and encumbrance of shares and interests (nearly all default rules)

We planned to have a chapter on entity selection, but we cut it. 😊